SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 932

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., AND LAWRENCE C. HAINES, TRUSTEES, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MARCH 27, 1945.

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 109384

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, Messrs William R. Kenan, Jr., and Lawrence C. Haines, Trustees, petitioners

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances: For Taxpayer: (Withdrawn), Geo. E. Cleary, Esq., S. Milton Simpson, Esq. For Comm'r: Thos. H. Lewis, Jr., Esq.

1941 DOCKET ENTRIES

Dec. 11—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 11—Copy of petition served on General Counsel.

Dec. 11—Notice of appearances of A. Roberts MacMannis as counsel filed. 12-11-41. Copy served.

Dec. 31—Answer filed by General Counsel.

Dec. 31—Request for hearing in New York filed by General Counsel.

1942

Jan. 5—Notice issued placing proceeding on New York City calendar. Service of answer and request made.

Dec. 21—Hearing set Jan. 25, 1943, New York City.

Dec. 26—Motion for continuance of 17 days filed by taxpayer. 12-30-42 Granted to 2-8-43.

1943

Jan. 8—Hearing set Feb. 8, 1943, New York City.

Feb. 8—Hearing had before Judge Tyson on the merits. Submitted. Stipulation of facts filed at hearing. Briefs due as per Rules.

Feb. 19—Motion to amend stipulation of facts in part, embodying amendment, filed by General Counsel. 2-20-43 Granted.

Mar. 2—Transcript of hearing Feb. 8, 1943 filed.

Mar. 5—Brief filed by taxpayer.

Mar. 25—Brief filed by General Counsel. Served 3-26-43

[fol. 2] 1943

Mar. 26—Copy of brief served on General Counsel.

Apr. 9—Reply brief filed by taxpayer. 4-9-43 Copy served on General Counsel.

Oct. 8—Findings of fact and opinion rendered, Tyson, Judge, Div. 1. Decision will be entered for the petitioners. 10-8-43. Copy served.

Oct. 8—Decision entered, Tyson, Judge, Div. 1.

Dec. 28—Petition for review by U. S. Circuit Court of Appeals, 2nd Circuit, with assignments of error filed by General Counsel.

1944

Jan. 3—Proof of service filed by General Counsel. (2).

Jan. 22—Notice of the appearance of Geo. E. Cleary as counsel and S. Milton Simpson filed.

Jan. 22—Motion requesting leave to withdraw as counsel filed by A. Roberts MacMannis, filed.

Jan. 24—Motion requesting leave to withdraw as counsel filed by A. Roberts MacMannis, granted.

Feb. 24—Motion for extension to 4-26-44 to prepare and transmit the record filed by General Counsel.

Feb. 24—Order enlarging time to 4-26-44 to prepare and transmit the record entered.

Apr. 18—Motion for extension to 6-24-44 to prepare and transmit the record filed by General Counsel.

Apr. 18—Order enlarging time to 6-24-44 to prepare and transmit the record entered.

May 22—Praecipe for record filed with proof of service thereon.

[fol. 3] Before United States Board of Tax Appeals

Trust U/W of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr., and Lawrence C. Haines, Trustees, petitioners,

v.

Commissioner of Internal Revenue, Respondent

Received Dec. 11, 1941. Chief Counsel's Office for the Bureau of Internal Revenue.

Received Dec. 11, 1941. U. S. Board of Tax Appeals.

Petition

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Second New York Division, LAL-90D) dated September 19, 1941, and as a basis of their proceeding allege as follows:

1. The petitioners are fiduciaries with principal office at 120 Broadway, Room 1823, New York, New York. The petitioners' income tax return for the period here involved was filed with the Collector of Internal Revenue for the Second District of New York, Customhouse, New York, New York.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioners on September 19, 1941.

[fol. 4] 3. The taxes in controversy are income taxes for the calendar year *1940* and in the amount of *$160,815.10*.

4. The determination of tax set forth in the said notice of deficiency is based on the following error:

(*a*) The Commissioner of Internal Revenue erroneously held that the petitioners are not engaged in carrying on a trade or business within the meaning of Section 23 (a) of the Internal Revenue Code as amended, and are not entitled to expense deductions in the total amount of $210,741.93, on the erroneous theory that said expenses are not ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of Section 23 (a) of the Internal Revenue Code as amended.

5. The facts upon which the petitioners rely as the basis for this proceeding are as follows:

(*a*) Mary Lily (Flagler) Bingham died July 27, 1917, leaving a last will and testament which was duly admitted to probate on August 3, 1917.

(*b*) During the calendar year 1940 and at the present time petitioners were the duly appointed and acting trustees under said will.

(*c*) Item Ninth of said will provides as follows:

> "All the rest and residue of my estate including all lapsed bequests or devises, shall be held for the

term of twenty-one years from the date of this will by my said Trustees in trust for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties (which are hereinafter called 'principal properties') and the properties held by subsidiary Com-
[fol. 5] panies. And to that end, my said Trustees shall have power to sell any of my said residue estate, except the stocks and bonds of said 'principal properties,' to invest the proceeds of such sales and the income and increments of all my said residue estate in such securities or other properties as they may think best; to use any of the said proceeds or said income or increments for the benefit of any of said principal or subsidiary properties; to make and execute any and all obligations, and all pledges and mortgages of any of my said residue estate except the stocks and bonds of the said principal properties, which may be necessary for the purposes of the maintenance, administration or development of the said principal or subsidiary properties; to exchange any of said properties, other than the principal properties, and the stocks and bonds thereof, for any property which to them may seem desirable to be acquired for the benefit of the said principal or subsidiary properties, and continuingly to invest, sell and reinvest at such times and in such manner and in such sums and in such properties as may seem to them desirable for the purpose of carrying out the maintenance, administration and development of the said properties, the primary purpose of this trust being the keeping together of the enterprise into which my beloved husband, Henry M. Flagler, put so much of his energy, ambition and life."

(*d*) Item Fourteenth of said will provides as follows:

"Each of my said Trustees shall receive for his services as Trustee compensation at the rate of fifty thousand ($50,000.00) Dollars per year and such com-
[fol. 6] sation shall cover all services which he may render as Executor and be in full to him for all services in both capacities."

(*e*) During 1940, pursuant to the power conferred on them by Item Ninth and by Item Fourteenth of said will,

the petitioners paid out as ordinary and necessary expenses of carrying on the business of the trust estate, the following:

Compensation of Trustees		$141,369.86
Office Salaries		34,934.30
Office Supplies and Expenses		2,448.97
Petty Cash Expenditures		1,722.89
Office Rent	$11,700.32	
Less: Reimbursements	8,281.22	
		3,419.10
Legal Expenses		25,867.31
Tax and Financial Services		498.75
Micellaneous Expenses		480.75
Total		210,741.93

(*f*) Pursuant to the provisions of Item Fourteenth of said will, the petitioners paid on August 3, 1940, to William R. Kenan, Jr. $50,000.00 and on the same date to Lawrence C. Haines $50,000.00, a total of $100,000.00, as compensation in full for all services rendered for the period beginning August 3, 1939, and ended August 2, 1940.

(*g*) Pursuant to the provisions of Item Fourteenth of said will, the petitioners paid on December 20, 1940, to William R. Kenan, Jr. $20,684.93 and on the same date to Lawrence C. Haines $20,684.93, a total of $41,369.86, in full and FINAL compensation for all services rendered as Trustees of said trust estate for the period beginning Aug- [fol. 7] ust 3, 1940 and ended December 31, 1940, on which latter date distribution of the testamentary trust estate was concluded, except for some minor non-income producing properties, not here in issue.

(*h*) Pursuant to the provisions of Item Ninth of said will, the petitioners paid during the year 1940, in addition to the compensation of said Trustees at the rate provided in Item Fourteenth of said will, ordinary and necessary office salaries, office rent, and other office expenses, as set forth in paragraph (e) hereof, all in connection with the carrying on of the trade or business of the testamentary trust estate.

(*i*) During the calendar year 1940 the "subsidiary" companies referred to in Item Ninth of the last will and testa-

ment of Mary Lily (Flagler) Bingham were the following:

Florida East Coast Car Ferry Company,
West Palm Beach Water Company,
Model Land Company,
Perrine Grant Land Company,
The Record Company,
St. Augustine Golf Development Company,
Chuluota Company,

which said "subsidiary" companies were in addition to the "principal properties" referred to in Item Ninth of said will, as follows:

Florida East Coast Railway Company,
Florida East Coast Hotel Company.

(j) During the calendar year 1940 the petitioners were engaged in carrying on the trade or business of the trust estate which trade or business was separate and distinct from the trade or business carried on by the principal and [fol. 8] subsidiary companies set forth in paragraph (i) hereof.

Wherefore, the petitioners pray that this Board may hear the proceeding and determine that there is no deficiency in federal income tax liability of petitioners for the calendar year 1940.

William R. Kenan, Jr., Trustee; Lawrence C. Haines, Trustee, 120 Broadway, Room 1823, New York, New York.

Duly sworn to by William R. Kenan, Jr. and Lawrence C. Haines. Jurats omitted in printing.

[fol. 9] EXHIBIT "A" TO PETITION

Treasury Department

Internal Revenue Service

Office of Internal Revenue Agent in Charge, Second New York Division.

Sept. 19, 1941.

Trust U/W of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr. and L. C. Haines, Trustees, Room 1823, 120 Broadway, New York, New York.

SIRS:

You are advised that the determination of your income tax liability for the taxable year(s) ended Dec. 31, 1940, [fol. 10] discloses a deficiency of $160,815.10 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Revenue Agent in Charge, 12th Floor, 225 Broadway, New York, N. Y., for the attention of LAL-90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, (Signed) by C. R. Krigbaum, Internal Revenue Agent in Charge.

Enclosures: Statement. Form of waiver.

[fol. 11] Statement

Trust u/w of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr., and L. C. Haines, Trustees, Room 1823, 120 Broadway, New York, New York

Tax Liability for Taxable Year Ended December 31, 1940

	Liability	Assessed	Deficiency
Income tax	$473,444.37	$312,629.27	$160,815.10

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated May 29, 1941; to your protest dated July 22, 1941; and to the statements made at the conferences held on August 19, August 28, and September 2, 1941.

Adjustment to Net Income

Net income as disclosed by return		$477,772.02
Unallowable deduction and additional income:		
(*a*) Other deductions		210,741.93
Net income adjusted		688,531.95

Explanation of Adjustment

(*a*) It is held that the following items claimed as deductions on line 13 of your return in the amount of $210,741.93 (part of a total of $261,741.93) are not ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of section 23 (a) of the Internal Reve- [fol. 12] nue Code as amended. Accordingly, the deductions have been disallowed.

Compensation of trustees		$141,369.86
Office salaries		34,934.30
Office supplies and expenses		2,448.97
Petty cash		1,722.89
Office rent	$11,700.32	
Less: credit	8,281.22	
		3,419.10
Tax and financial services		498.75
Legal expenses		25,867.31
Miscellaneous		480.75
Total		210,741.93

Trust u/w of Mary Lily (Flagler) Bingham

Statement

Computation of Tax, Internal Revenue Code as Amended	
Net income adjusted	$688,513.95
Minus: Net long-term capital gain	1,293.75
Ordinary net income	687,220.20
Less: Personal exemption	100.00
Balance (surtax net income)	687,120.20
Net income subject to normal tax	687,120.20
Normal tax at 4% on $687,120.20	27,484.81
Surtax on $687,120.20	423,764.14
Partial tax	451,248.95
Plus: 30% of net long-term capital gain of $1,293.75	388.13
Alternative tax	451,637.08
Less: Income tax paid at the source	1,880.40
Correct income tax liability	449,756.68
Defense tax—10%	23,687.69
Total income and defense taxes due	473,444.37
Total income and defense taxes paid:	
Original, Account No. 187022	312,629.27
Deficiency of income tax	160,815.10

[fol. 13] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and in answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Denies the allegations contained in paragraph 3 of the petition, except it is admitted that the taxes in controversy are income taxes for the calendar year 1940.

4. Denies the Commissioner committed error as alleged in paragraph 4 (a) of the petition, and each and every allegation of fact contained therein.

5. Denies the allegations contained in paragraph 5 (a) to (j) inclusive, of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

[fol. 14] Wherefore, it is prayed that the appeal be denied and the taxes as shown in the deficiency notice be in all respects approved.

J. P. Wenchel, H. D. T., J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: E. C. Algire, Division Counsel; Thos. H. Lewis, Jr., Special Attorney, Bureau of Internal Revenue. lmv 12/26/41.

IN THE TAX COURT OF THE UNITED STATES

[Title omitted]

The Tax Court of the U. S. Filed at Hearing Feb. 8, 1943. New York. Division 1. Docket 109384.

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the facts hereinafter set forth shall be taken as true, provided, how-
[fol. 15] ever, that this stipulation shall be without prejudice to the rights of either party to introduce other and further evidence not inconsistent with or contradictory of the facts herein stipulated to be taken as true.

1. Mary Lily (Flagler) Bingham died on July 27, 1917. Attached hereto and made a part hereof, marked "Exhibit A", is a true copy of her Last Will and Testament.

2. At all times since prior to January 1, 1940, the petitioners in this proceeding, William R. Kenan, Jr. and Lawrence C. Haines, were the duly qualified and acting Trustees under the Will of said Mary Lily (Flagler) Bingham. Said petitioners filed an income tax return on Form 1041 (For Estates and Trusts) for the calendar year 1940 with the Collector of Internal Revenue for the Second District of New York, showing a Federal income and defense tax due of $312,629.27, which was duly assessed and paid.

3. The respondent determined a deficiency in petitioners' Federal income and defense tax for the calendar year 1940 in the amount of $160,815.10. A true copy of the notice of deficiency, dated September 19, 1941, is attached to the petition herein as "Exhibit A" thereof.

4. During the calendar year 1940, pursuant to the powers conferred on them by Item Ninth and by Item Fourteenth of said will, the petitioners paid out a total of $210,741.93, in connection with the carrying on of the provisions of the [fol. 16] Last Will and Testament of Mary Lily (Flagler) Bingham which created the Trust Estate:

Compensation of Trustees		$141,369.86
Office Salaries		34,934.39
Office Supplies and Expenses		2,448.97
Petty Cash Expenditures		1,722.89
Office Rent	$11,700.32	
Less: Reimbursements	8,281.22	
		3,419.10
Legal Fees and charges paid to Root, Clark, Buckner & Ballantine, attorneys-at-law, as hereinafter itemized		25,867.31
Tax and Financial Services		498.75
Miscellaneous Expenses		480.75
Total		210,741.93

5. The books and accounts of the petitioners have at all times been kept on the basis of cash receipts and cash disbursements, and the Federal income tax return for the calendar year 1940 (as well as in all prior years) was filed on the same basis as that upon which the books and accounts were kept, viz., cash receipts and cash disbursements.

6. Of the items disallowed in the said deficiency notice, (Exhibit "A" of the petition) the following are ordinary

and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation or maintenance of property held for the production of income:

Compensation of Trustees	$141,369.86
Office Salaries	34,934.30
Office Supplies and Expenses	2,448.97
Petty Cash Expenditures	1,722.89
Office Rent (net)	3,419.10
Tax and Financial Services	498.75
Miscellaneous Expenses	480.75
Total	184,874.62

[fol. 17] 7. During the calendar year 1940 the petitioners paid to Root, Clark, Buckner & Ballantine, attorneys-at-law, for legal fees and charges a total of $25,867.31, as follows:

	Fees	Expenses
Jan. 10 For services from August 27, 1937 to January 2, 1940 in contesting asserted deficiency in federal income tax for 1935 of $365,687.12 and expenses for stenographers, postage, telephone and telegraph, etc. (For particulars of this litigation see 40 B. T. A. 823)	$7,500.00	$259.21
Mar. 22 Stenographic services		228.75
Board of Tax Appeals—fee for filing appeal record		6.65
United States Circuit Court of Appeals—fee for filing transcript of record (For particulars of this litigation see 40 B. T. A. 823)		6.50
May 15 Stenographic services, postage, telephone tolls, etc., in connection with 1935 income tax deficiency. (For particulars of this litigation see 40 B. T. A. 823)		130.98
May 22 For services in connection with the payment of legacy to the University of North Carolina, under Item Eighth of Mrs. Bingham's Will	750.00	

		Fees	Expenses
	Stenographic services		30.85
July 11	Cost of printing transcript of record and briefs on appeal		407.92
	Stenographic services		162.05
	Telephone, postage, filing fees, etc. (For particulars of this litigation see 40 B. T. A. 823)		63.15
Sept. 23	Stenographic services, filing fees, telephone tolls, postage, etc., in connection with 1935 income tax deficiency, and termination of trust. (For particulars of this litigation see 40 B. T. A. 824)		160.17
[fol. 18]			
Dec. 6	Stenographic services in connection with termination of the trust		38.40
Dec. 13	For services in connection with the appeal on the federal income tax deficiency of $365,687.12 for the year 1935. (For particulars of this litigation see 114 F. (2d) 217)	7,500.00	14.58
Dec. 30	For services in considering the tax problems resulting from the expiration of the trust, advice as to the present status of the Trust for tax purposes, and as to various methods whereby the various properties of the Trust might be continued as a single unit in the future; investigation of various questions of law and preparation for the Trustees of a memorandum in which the recommendation was made that the stocks of certain companies owned by the Trust be placed in one or more Voting Trusts; formation of Voting Trusts; advice relative to indebtedness owed by two of the principal corpora-		

	Fees	Expenses
tions; preparation of documents; and assisting the Trustees in delivery of the assets of the Trust to the legatees	8,500.00	
Stenographic services and telephone tolls		108.10
Totals	$24,250.00	$1,617.31
	1,617.31	
Grand Total	$25,867.31	

Dated January 1943.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue. A. Roberts MacMannis, Counsel for Petitioners.

[fol. 19] EXHIBIT "A" TO STIPULATION OF FACTS

I, Mary Lily Flagler, do make, declare and publish this my last will and testament hereby revoking all former wills and testaments made by me:

Item First

I direct that all my debts, funeral expenses and the expenses of carrying out and administering the provisions of this instrument shall be fully paid.

Item Second

I hereby appoint Wm. R. Kenan, Jr., of the City of Lockport, in the State of New York, and Wm. A. Blount, of the City of Pensacola in the State of Florida, as the executors of and trustees under this my last will and testament, and I do hereby exempt them and each of them from the giving of any bond which may be required under any law or by any Court, and also exempt them from the filing of any inventories or accounts of my estate or of the administration thereof; and from the provisions of any law prescribing or restricting the character of property or securities in which they may invest the principal or income or other increments of my estate, as hereinafter provided.

Item Third

I give and devise unto my beloved niece, Louise Clisby Wise, if she shall survive me, all the real estate, wherever situated, which is now owned by me excluding from this [fol. 20] devise any real estate the title to which is vested in the Trustees under the will of my late husband Henry M. Flagler. While the absolute title and power of disposition will be in my said niece, it is my wish that if she does not dispose of the said property during her lifetime she shall dispose of it by will by which her father and any wife or children of him shall be excluded from any interest therein or use thereof.

Item Fourth

I give and bequeath to my said niece all my pearls, and to my brother's wife, Alice, one piece of jewelry, to be selected by my said Trustees, and to my sisters, Jessie Kenan Wise and Sarah Graham Kenan, all the rest of my jewelry share and share alike to be divided between them by my said Trustees, and their division to be final.

Item Fifth

All the rest and residue of the property, real and personal, of which I shall die seized and possessed, I give, devise and bequeath unto the said Wm. R. Kenan, Jr., and Wm. A. Blount, and their successors and assigns. In trust, however, as follows:

1. I give and bequeath unto and my Trustees shall deliver upon my death to my brother Wm. R. Kenan, Jr., my sister, Sarah Graham Kenan and my sister, Jessie Kenan Wise share and share alike the following oil stocks now owned by me to-wit:

Six thousand and fifty (6050) shares California Standard Oil Company stock;
[fol. 21] Forty-eight hundred (4800) shares Indiana Standard Oil Company stock;
Three Hundred (300) shares Kansas Standard Oil Company stock;
Four hundred and fifty (450) shares Kentucky Standard Oil Company stock;
One hundred and Fifty (150) shares Nebraska Standard Oil Company stock;

Sixteen Thousand (16000) shares New Jersey Standard Oil Company stock;

Twelve Thousand (12000) shares New York Standard Oil Company stock;

Five Hundred (500) shares Ohio Standard Oil Company stock.

If at the time of my death the said stocks shall be of less market value than their par values, my Trustees shall in addition to turning over to each of the said legatees one-third of said stocks, pay to each of them in cash the difference between the said par value and the said market value.

If any of the said stocks shall be sold by me before my death, the legacies herein given shall not fail as to said stocks so sold, but my Trustees shall upon my death pay to the said legatees share and share alike, the principal sum or sums for which I shall have sold the said stocks.

If my said brother or my sister, Jessie Kenan Wise, shall die before my death, the legacy to him or her herein provided for shall fail. But if my brother shall die before me, leaving a wife living at my death my Trustees shall pay to [fol. 22] her one-half Million ($500,000.00) Dollars and if my said sister, shall die before me, leaving a husband living at my death my Trustees shall pay to the said husband surviving one-half Million ($500,000,00) Dollars.

If my said sister, Sarah Graham Kenan shall die before me, leaving at my death no children the legacy to her herein provided for shall fail. But if she shall die before me leaving a husband, but no children living at my death my Trustees shall pay to him One-half Million ($500,000.00) Dollars. If however, my said sister shall die leaving living at my death a child or children or a child or children and a husband, then the legacy to my said sister herein provided for shall go to the said child, if there be but one, and there be no husband, or to the children share and share alike, if there be more than one and no husband, or to the husband and the child or children if there be a husband share and share alike.

2. I give to each of the following persons and my Trustees shall pay to them the following sums of money to-wit:

a. To my cousin Owen Kenan Three Hundred Thousand ($300,000.00) Dollars with deep affection from me.

b. To my faithful pastor and friend Dr. George Morgan Ward, twenty-five thousand ($25,000.00) Dollars.

c. To my cousin Emily Kenan, Twenty thousand ($20,000.00) Dollars.

d. To my cousin Thomas S. Kenan, Twenty thousand ($20,000.00) Dollars.

[fol. 23] *e.* To my Godchild, Mary Pope, daughter of John Russell Pope, of New York Twenty thousand ($20,000.00) Dollars.

f. To Mrs. Janet Mitchell (widow) of Raleigh, North Carolina, Twenty thousand ($20,000.00) Dollars.

g. To Mrs. J. B. McClellan, daughter of Mrs. Berry York of Cleveland, Ohio, Two thousand ($2,000.00) Dollars to be used by her for the purchase for her personal use of some thing in remembrance of me.

h. To W. H. Beardsley, Twenty-five thousand ($25,000.00) Dollars in appreciation for all his kindness to me.

i. To my faithful servant, Mary Monk, of Raleigh, North Carolina, Four thousand ($4,000.00) Dollars.

j. With deep affection to my faithful servant, Ida Remley Ten Thousand ($10,000.00) Dollars.

k. To Mary — (my cook) five thousand ($5,000.00) Dollars.

l. To George Holland, Five Thousand ($5,000.00) Dollars.

m. To James Weeks, Ten Thousand ($10,000.00) Dollars.

n. To Mollie Dick, wife of W. A. Dick, of Wilmington, North Carolina Ten Thousand ($10,000.00) Dollars.

o. To Mrs. Sue Corprew, wife of Burruss Corprew, of Norfolk, Virginia, Five Thousand ($5,000.00) Dollars.

p. To my Godchild John Lucas, son of Eugene Van Court Lucas, of Sound Beach, Connecticut, Five Thousand ($5,000.00) Dollars.

[fol. 24] *q.* To such persons as were Managers of the Ponce de Leon, Alcazar Ormond Beach, Royal Poinciana, The Breakers, Royal Palm and Colonial Hotels, at the time of the death of my husband, Henry M. Flagler, and who shall also be Managers of said Hotel at my death, Ten thousand ($10,000.00) Dollars each.

r. To the Trustees of the Memorial Presbyterian Church Society of Saint Augustine, Florida, Ten thousand ($10,000.00) Dollars.

s. To the Flagler Hospital at Saint Augustine, or to such Trustees, or other body representing it as may be entitled to receive the same, Ten Thousand ($10,000.00) Dollars.

t. To The Presbyterian Church, at Miami, Florida, or to such Trustees or other body representing it as may be entitled to receive the same, Ten Thousand ($10,000.00) Dollars.

u. To Miss Hannah P. Bolles of Wilmington, North Carolina, Ten Thousand ($10,000.00) Dollars.

v. To each of my servants who shall at the time of my death have been with me for the five immediately preceding consecutive years, One Thousand ($1,000.00) Dollars.

w. If any person to whom a legacy is given by this paragraph (Item Fifth, Paragraph 2) shall die before me, leaving a husband or wife, or child or children, living at my death such husband or wife or child or children, shall take the legacy herein given to the husband or wife or parent, as the case may be. And if the person so dead shall leave two or more of the said representatives, they shall take the legacy share and share alike.

[fol. 25] Item Sixth

I direct that each of the foregoing legacies given by paragraphs 1 and 2 of Item Fifth of this will shall be paid by my said Trustees as soon as in their judgment is compatible with the due administration of my estate and with the carrying out of my wishes with reference to the Florida East Coast Railway Company and the Florida East Coast Hotel properties hereinafter mentioned. Each of said money legacies shall bear interest from the time of my death until the time of its payment at the rate of four per cent per annum.

Item Seventh

That my said Trustees shall pay to my said niece, Louise Clisby Wise, the sum of Two Hundred Thousand ($200,000.00) Dollars annually until she shall have arrived at the age of forty (40) years at which time or as soon thereafter as compatible with the interests of my estate, they shall pay to her the sum of Five Million ($5,000,000.00) Dollars. If she shall die unmarried before my death or after my death and before she shall be forty years of age, this legacy shall fail but if she shall, before my death die married leaving living at my death a husband or child or children or after my death and before she shall be forty years of age, die married, leaving a husband and child or children the foregoing legacy shall go to them in equal shares, pay-

able at my death, if she die before me or upon her death, if she die after me, or in either case, as soon as compatible with the interests of my estate. But if she shall before my [fol. 26] death, die married, leaving only a husband living at my death, or die married after my death and before she shall be forty years of age, leaving only a husband living he shall receive from my Trustees, upon my death, if she die before me, or upon her death, if she die thereafter and before she shall be forty years of age, or in either case, as soon thereafter as compatible with the interests of my estate, the sum of One Million ($1,000,000.00) Dollars. The compatibility in every event above shall be determined absolutely by my Trustees.

Item Eighth

I give and bequeath and direct my Trustees to pay annually to the University of North Carolina, or such Trustees or other body representing it as may be entitled to receive the same, seventy-five thousand ($75,000.00) Dollars such sum however to be paid and received upon the trust that it shall be perpetually used by said University for the purpose of paying the salaries of professors thereof upon the condition that each of the professorships the salary of which is thus paid, shall be known as a Kenan Professorship this bequest being given in the interest of education of the youth of North Carolina, and also in memoriam of my father, Wm. R. Kenan, and my uncles, Thomas S. Kenan and James Graham Kenan, graduates of the said University. The said annual sum is to be paid during the continuance of the trust of my said Trustees and at the end of the said trust the said Trustees are to pay to the said University such sum in cash as at the rate of interest then [fol. 27] current in North Carolina will produce an annual income of seventy-five thousand ($75,000.00) Dollars, the amount of such sum to be determined by my said Trustees.

The Trustees may at their discretion if they think it compatible with the interests of my estate and the purpose of the trustee hereby created in them pay the said sum at any time prior to the expiration of the trust.

Item Ninth

All the rest and residue of my estate including all lapsed bequests or devises, shall be held for the term of twenty-

one years from the date of this will by my said Trustees in trust for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties (which are hereinafter called "Principal properties") and the properties held by subsidiary Companies. And to that end, my said Trustees shall have power to sell any of my said residue estate, except the stocks and bonds of said "principal properties," to invest the proceeds of such sales and the income and increments of all my said residue estate in such securities or other properties as they may think best; to use any of the said proceeds or said income or increments for the benefit of any of said principal or subsidiary properties; to make and execute any and all obligations, and all pledges and mortgages of any of my said residue estate except the stocks and bonds of the said principal properties, which may be necessary for the purposes of the maintenance, administration or development of the said princi- [fol. 28] pal or subsidiary properties; to exchange any of said properties, other than the principal properties and the stocks and bonds thereof, for any property which to them may seem desirable to be acquired for the benefit of the said principal or subsidiary properties, and continuingly to invest, sell and reinvest at such times and in such manner and in such sums and in such properties as may seem to them desirable for the purpose of carrying out the maintenance, administration and development of the said properties the primary purpose of this trust being the keeping together of the enterprise into which my beloved husband, Henry M. Flagler, put so much of his energy, ambition and life.

Item Tenth

At the end of the said twenty-one years, the said Trustees shall divide the property then in their hands into three (3) equal parts, and shall execute such instruments, conveyances and transfers as may be necessary to vest one of said parts in each my brother, Wm. R. Kenan, Jr., my sister Mrs. Jessie Kenan Wise, and my sister Mrs. Sarah Graham Kenan and upon such transfers, conveyances and assignments the said trust shall cease. The judgment of the said Trustees as to the equality of the said parts shall be final.

If at the said time my brother Wm. R. Kenan, Jr., shall be dead, the legacy to him herein provided for shall fail; but if his wife shall be living, my Trustees shall pay to her the sum of Five Million ($5,000,000.00) Dollars. If he and [fol. 29] she shall both be dead, then the share which would have gone to him and to her under this item of my will, shall go to my sisters aforenamed, if they be then alive, share and share alike, or, if there be only one alive, then to the survivor.

If at the said time my sister Sarah Graham Kenan shall be dead, leaving no children the legacy to her herein provided for shall fail. But if she shall die before said time leaving a husband, but no children living at said time, my Trustees shall pay to him Five Million ($5,000,000.00) Dollars.

If, however, my said sister shall die leaving living at said time a child or children or a child or children and a husbond, then the legacy to her herein provided for shall go to the said child, if there be one, and there be no husband or to the children, share and share alike, if there be more than one, and no husband, or to the husband and to the child or children if there be a husband, share and share alike.

If my sister, Jessie Kenan Wise, at the said time, shall be dead this legacy to her herein provided for shall fail; but if she shall leave a husband living at said time my Trustees shall pay to him the sum of Five Million ($5,000,000.00) Dollars. If she shall be dead, leaving no husband, then the share which would have gone to her under this item of my will shall go to my brother and other sister aforenamed, if they be then alive, share and share alike, or, if there be only one alive, then to the survivor.

If all of the said brother and sisters shall die before the expiration of the said trust and my sister, Sarah Graham Kenan shall have no child or children and the aforesaid [fol. 30] Louise Clisby Wise shall be then living all of the property provided to go to my said brother and sisters by this paragraph shall go to the said Louise Clisby Wise. This provision however, shall not affect the provision hereinbefore made for the wife of my brother and the husband or husbands of my sister or sisters.

If the said Louise Clisby Wise shall die before the expiration of the said trust all the said residue estate shall

go to my heirs and distributees as determined by the now existing Law of Florida.

While the absolute title and power of disposition will be in my said niece, in the event that the said property shall vest in her, it is my wish that if she does not dispose of the said property during her life time she shall dispose of it by will in which her father, and any wife or children of him shall be excluded from any interest therein or use thereof.

Item Eleventh

My Trustees shall have the right to sell any of the property vested in them by this will (except the stocks and bonds of the principal properties) for the purpose, if necessary of paying any sum of money required to be paid by this will. They shall have the right, in the case of any such payment (except of the legacies given in Item Fifth, Paragraph 2) to substitute for the payment in money, payment in marketable securities of a value equal to the sum to be paid, the selection of the securities to be substituted in any instance, and the valuation of such securities to be done [fol. 31] by the Trustees and their selection and valuation to be final.

Item Twelfth

If any one of the said Trustees and Executors hereinunder shall at the time of my death not be living, or shall refuse or be unable to serve the remaining Trustee qualified and acting shall with the approval of the Circuit Judge of the Circuit embracing St. Johns County, Florida, fill the vacancy. If both be dead, or refuse or be unable to serve the said Judge shall fill the vacancies. Any vacancy or vacancies at any time thereafter occurring shall be filled in like manner. Each Trustee shall by virtue of his office as Trustee be also Executor of this will. Every substituted Trustee and Executor shall have all the title and exercise all the powers and have imposed upon him all the duties herein given to or imposed upon each of the Trustees and Executors herein named.

Item Thirteenth

I do further direct, ordain and declare and it is my will that if any person named in this instrument as a beneficiary or legatee, or devisee or any one interested there-

under shall at any time or in any manner institute, or cause to be instituted, or shall aid, abet, connive at or directly or indirectly promote the institution of any contest of proceeding or litigation contesting or intending to contest, defeat or obstruct, this instrument or any provision thereof, or the enforcement of any such provision then any and every such offending person or persons whether nat- [fol. 32] ural or artificial shall whether such contest proceeding or litigation be successful or not, thereby forfeit all interest under this instrument and the provision made in and by such instrument for any such offending person shall be of no effect and this instrument shall be executed and carried into effect as if such person were not therein named and no provision had been made therein as to or for such person.

Item Fourteenth

Each of my said Trustees shall receive for his services as Trustee compensation at the rate of fifty thousand ($50,000.00) Dollars per year and such compensation shall cover all services which he may render as Executor and be in full to him for all services in both capacities.

In witness whereof, I have hereunto and to each of the preceding typewritten twelve (12) pages which together with this typewritten page constitute my will set my hand and seal at White Sulphur Springs, in the County of Greenbrier and State of West Virginia, this 23d day of September, A. D. 1916.

Mary Lily Flagler. (Seal.)

Signed and sealed by the said Mary Lily Flagler in our presence and in the presence of each of us who in her presence and in the presence of each other and at her request sign our names hereto as witnesses.

J. Howard Slocum, Owen J. McLaughlin, S. B. Capito.

[fol. 33] State of Florida,
County of Palm Beach.

Be it remembered that on this 3rd day of August, A. D. 1917, I have duly recorded the foregoing will in the public records of said County.

Jerome E. Wideman, County Judge. (Seal.)

I, Mary Lily Bingham, wife of Robert W. Bingham of Louisville, Kentucky, being advised that my marriage to

him may have revoked a last will and testament made by me on the 23rd day of September, A. D. 1916, do hereby republish, re-affirm, adopt and declare the aforesaid instrument as my present will and testament in like manner as if the said will and testament were now executed by me.

In witness whereof, I have hereunto set my hand and seal this 8th day of December, A. D. 1916.

Mary Lily Bingham. (Seal.)

Signed and sealed by Mary Lily Bingham in our presence and in the presence of each of us, who at her request and in her presence and in the presence of each other hereunto sign our names as witnesses;

Stanley E. Slóss, of Louisville, Ky.; Emanuel Levi, of Louisville, Ky.; Emily A. Overman, of Louisville, Ky.

I, Robert W. Bingham, husband of Mary Lily Bingham, having been made acquainted with the contents of the will and testament above mentioned, made on the 23rd day of September (A. D. 1916, do hereby signify my assent to the re-publication, adoption, re-affirmation and re-declaration by my said wife of the said will.

In witness whereof, I have hereunto set my hand and seal this 8th day of December, A. D. 1916.

Robert W. Bingham. (Seal.)

[fol. 34] Signed, sealed and delivered in the presence of: Stanley E. Sloss, Emanuel Levi, Emily A. Overman.

STATE OF FLORIDA,
County of Palm Beach.

Be it remembered that on this 3d day of August, A. D. 1917, I have duly recorded the foregoing republication of will in the public records of said County.

Jerome E. Wideman, County Judge. (Seal.)

Palm Beach, Florida

March —, 1917.

I, Mary Lily Bingham, do hereby as a Codicil to my last will and testament, which I have heretofore made as Mary Lily Flagler direct my executors and Trustees to pay to the

Trustees or other governing body of the Flagler Hospital at Saint Augustine, Florida, a sum towards the construction and furnishing of said Hospital, not exceeding the sum of One hundred and twenty-five thousand dollars ($125,000.00) less such sums as may have been advanced by me or by my direction for said purposes prior to my death.

Mary Lily Bingham.

Signed, sealed and delivered by Mary Lily Bingham in the presence of her and of each of us, who at her request hereto sign our names as witnesses.

Owen Kenan, Sydney Capon.

[fol. 35] STATE OF FLORIDA,
County of Palm Beach.

Be it remembered that on this 3rd day of August, A. D. 1917, I have duly recorded the foregoing Codicil in the public records of said County.

Jerome E. Wideman, County Judge. (Seal.)

Dr. M. L. Ravitch

Louisville, Ky., June 19, 1917.

I make this a codicil to my last will and it shall be a valid devise as such codicil and if at my death I have no will or have a will or wills made subsequently to this instrument it shall nevertheless be an independent devise at all times and under all circumstances of change, modification or revocation of my present will or any will or wills. I give and bequeath to my husband, R. W. Bingham, five million ($5,000,000) Dollars to be absolutely his, and he shall have the option at my death of taking this from my estate in money or in such securities as he and the administering authorities of my estate may agree upon with respect to market values.

Witness my hand on the date above shown.

Mary Lily Bingham.

Witnesses, W. W. Davies, M. L. Ravitch.

Samuel W. Greene, Judge.

[fol. 36] IN THE TAX COURT OF THE UNITED STATES

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 109384. Promulgated October 8, 1943

Under the facts, certain legal and miscellaneous expenses paid by petitioners *held* to be deductible from gross income as "non-trade or non-business expenses" under section 23(a) of the Internal Revenue Code as added by section 121 of the Revenue Act of 1942.

A. Roberts MacMannis, C. P. A., for the petitioners.
Thos. H. Lewis, Jr., Esq., for the respondent.

The respondent determined a deficiency in income tax against the petitioners for the calendar year 1940 in the amount of $160,815.10. The issue presented is whether the respondent erred in disallowing certain expense deductions taken by petitioners on their income tax return for that year.

The proceeding has been submitted upon the pleadings and a stipulation of facts. The stipulated facts not set forth are included herein by reference, except as hereinafter noted in the opinion.

FINDINGS OF FACT

At all times since prior to January 1, 1940, the petitioners were the duly qualified and acting trustees of a trust created by the will of Mary Lily (Flagler) Bingham, herein- [fol. 37] after mentioned. Their principal office was in New York, New York. They filed their income tax return for the taxable year with the collector of internal revenue for the second district of New York. Their books and accounts have always been kept on a cash basis and the income tax return filed by them for the taxable year was filed on the same basis.

Mary Lily (Flagler) Bingham died on July 27, 1917. By her will, which was dated September 23, 1916, and duly probated in August 1917, she appointed two in-

dividuals as executors and trustees and, after providing for a certain devise of real estate and certain specific bequests of jewelry, provided for the conveyance to the trustees of all the residue of the property, real and personal, of which she should die seized and possessed. The will provided for the payment by the trustees to various parties of at least $536,000 in cash legacies and for the delivery by the trustees to various other parties of 40,250 shares of Standard Oil Co. stock. All those beneficiaries were to receive their legacies as soon as compatible with the due administration of the estate and the carrying out of the testator's wishes with reference to the hotel and railroad properties mentioned in item ninth of the will hereinafter set out. The will further provided for the payment of $200,000 annually to a niece of the testator until that niece attained the age of 40 years, when she was to be paid the lump sum of $5,000,000, if compatible with the interest of the estate as determined by the trustees. The will also [fol. 38] provided that the trustee should pay $75,000 annually to the University of North Carolina during the continuance of the trust and at the expiration thereof should pay to the university such a sum in cash as would produce an annual income of $75,000.

Item ninth of the will provided as follows:

> All the rest and residue of my estate including all lapsed bequests or devises, shall be held for the term of twenty-one years from the date of this will by my said Trustees in trust for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties (which are hereinafter called "Principal properties") and the properties held by subsidiary Companies. And to that end, my said Trustees shall have power to sell any of my said residue estate, except the stocks and bonds of said "principal properties," to invest the proceeds of such sales and the income and increments of all my said residue estate in such securities or other properties as they may think best; to use any of the said proceeds or said income or increments for the benefit of any of said principal or subsidiary properties; to make and execute any and all obligations, and

all pledges and mortgages of any of my said residue estate except the stocks and bonds of the said principal properties, which may be necessary for the purposes of the maintenance, administration or development of the said principal or subsidiary properties; to exchange any of said properties, other than the principal properties and the stocks and bonds thereof, for any property which to them may seem desirable to be acquired for the benefit of the said principal or subsidiary [fol. 39] properties, and continuingly to invest, sell and reinvest at such times and in such manner and in such sums and in such properties as may seem to them desirable for the purpose of carrying out the maintenance, administration and development of the said properties the primary purpose of this trust being the keeping together of the enterprise into which my beloved husband, Henry M. Flagler, put so much of his energy, ambition and life.

The will further provided that each of the trustees should receive compensation at the rate of $50,000 a year for services as trustee and such compensation also should cover all services which each trustee might render as executor.

At the end of 21 years from the date of the will the trustees were to divide the property then in their hands into three equal parts and transfer such parts to the testator's two sisters and brother in equal shares.

The respondent's determination of a deficiency resulted from the allowances of $210,741.93 expenses paid by petitioners in the taxable year and deducted by them from gross income in their income tax return for that year. The respondent's reason for the disallowance of these expenses was that they were not ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of section 23 (a) of the Internal Revenue Code. By stipulation the parties have agreed that all of the expenses originally disallowed by the respondent were ordinary and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held [fol. 40] for the production of income, save one item of

$25,867.31 paid for legal fees and charges. The expenses so agreed upon are as follows:

Compensation of trustees	$141,369.86
Office salaries	34,934.30
Office supplies and expenses	2,448.97
Petty cash expenditures	1,722.89
Office rent (net)	3,419.10
Tax and financial services	498.75
Miscellaneous expenses	480.75
Total	184,874.62

Of the legal fees and charges of $25,867.31 paid by the petitioners, $16,439.96 was incured for services rendered from August 1937 to January 1940 in contesting a deficiency of $365,687.12 in income tax asserted against the petitioners for the year 1935. This deficiency was asserted by reason of the inclusion by the Commissioner in income of alleged gains of $1,991,316.75 resulting from the partial payment in 1935 in securities of a bequest to Louise Clisby Wise of $5,000,000 under the above mentioned will. The payment was made under the provision of the will that when Louise Clisby Wise reached the age of forty, or as soon thereafter as was compatible with the interests of the estate, she was to be paid the sum of $5,000,000. When Louise Clisby Wise became forty years of age the trustees paid her $5,000,000, partly in cash and partly in securities. Some of the securities had been purchased by the trustees and some had been received by the trustees as part of the estate of the decedent at her death, which later securities had appreciated in value during the period held by the trustees, and the respondent determined that, to the extent [fol. 41] that the value of the securities purchased exceeded their cost and to the extent of the appreciation of the other securities, the distribution thereof resulted in capital gains taxable as specified in section 117 of the Revenue Act of 1934. In the case of *William R. Kanan, Jr., et al., Trustees*, 40 B. T. A. 824, we sustained the respondent's determination of the deficiency. Our decision sustaining the deficiency was appealed to the Circuit Court of Appeals for the Second Circuit. That Circuit Court, in *Kenan* v. *Commissioner*, affirmed our decision in 114 Fed. (2d) 217. The legal fees here in dispute were paid for services rendered

by attorneys in connection with the proceeding there before us and in connection with the appeal therefrom. Payments to the attorneys also covered reimbursements for expenses incurred by them in contesting the deficiency.

Of the legal fees and charges paid by the petitioners, the amount of $780.85 was for services in connection with the payment of the above mentioned legacy to the University of North Carolina and for stenographic expense incurred by the attorneys in connection with those services.

The remaining $8,646.50 of the total of $25,867.31 in legal fees and charges paid by the petitioners in 1940 was for services rendered in respect of the tax and other problems resulting from the expiration of the trust and delivery of its assets to the legatees.

OPINION

TYSON, *Judge*: The parties have stipulated that $184,874.62 of the expenses in question were ordinary and [fol. 42] necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, and respondent, on brief, concedes that such amount is deductible. We accordingly hold that those expenses are deductible from petitioners' gross income.

The question is then presented as to whether the other expenses of $25,867.31 are also deductible from petitioners' gross income.

Petitioners' first contention is that under item ninth of the will they, as trustees, were carrying on the business of the maintenance, administration, and development of the properties of the hotel, railway, and subsidiary companies, stocks and bonds of which companies were owned by them, the amount thereof and their proportions of the totals outstanding not being shown; that the expenses were incurred and paid in that business; and that those expenses are consequently deductible under section 23 (a) (1) of the Internal Revenue Code or that subsection as carried forward into section 121 of the Revenue Act of 1942. Petitioners make no argument that they were carrying on a business of any other character.

There is nothing in the record showing in what activities, if any, petitioners were engaged with reference to the

maintenance, administration, or development of the properties of the hotel, railway, and subsidiary companies, and there is also nothing in the record to show that the petitioners participated, directly or indirectly, in the manage-[fol. 43] ment of any of those companies or their properties. We are therefore unable to say that the trustees were engaged in the carrying on of the business of the maintenance, administration, or development of such properties, as contended by petitioners. In reaching this conclusion we have not overlooked that part of the stipulation of facts stating that the expenses were paid by the trustees "pursuant to the powers conferred on them by Item Ninth * * * of said will." The trustees were empowered by item ninth to sell, invest, and reinvest, and to use the income and increment, and to mortgage, pledge, and exchange properties, for the purpose of maintaining, administering, or developing the principal properties; but the amounts here in question, as shown by our findings and as itemized in the stipulation, clearly were not expended in the exercise of any of these powers. In this situation we are not bound by the conclusion contained in the part of the stipulation quoted above and that portion must be disregarded in determining whether the trustees were engaged in the carrying on of the business of the maintenance, administration, or development of the principal properties of the hotel, railway, and subsidiary companies, as contended by the petitioners. *Ernst Kern Co.*, 1 T. C. 249, 265; *William Ernest Seatree*, 25 B. T. A. 396; affd., 72 Fed. (2d) 67; *T. K. Harris Co.*, 38 B. T. A. 383; affd., 112 Fed. (2d) 76.

Assuming however that the trustees were engaged in carrying on the business of the maintenance, administration, [fol. 44] and development of the properties of the hotel, railway, and subsidiary companies, it is clear that none of the $25,867.31 expenses was incurred or paid for the purpose of the carrying on of that business. All of it was incurred and paid in connection with the payment of legacies and distributions from the estate by the trustees to the beneficiaries entitled thereto and the expiration of the trust, as is shown in our findings and the itemization of those expenses in the stipulation of facts.

We are of the opinion, and so hold, that the expenses of $25,867.31 were not expenses incurred and paid in carrying on a trade or business within the provision of section 23

(a) (1) of the Internal Revenue Code or of that subsection as carried forward into section 121 of the Revenue Act of 1942, as contended by petitioners.

Since the determination of the deficiency herein Congress has enacted section 121 of the Revenue Act of 1942, retroactively amending section 23 (a) of the Internal Revenue Code,[1] and that section as amended applies to the taxable [fol. 45] year here involved. Therefore, there remains the question of whether the expenses we are considering are deductible under that amendment. Section 121, *supra*, is applicable to the income of a trust such as the one here involved. (Secs. 161 and 162, Internal Revenue Code.)

Petitioners contend alternatively that, if the expenses were not incurred and paid in the carrying on of a business, they were paid and incurred as a "nontrade or nonbusiness expense" within that provision of section 23 (a) (2) of the Internal Revenue Code as added by section 121 (a) of the

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[1] SEC. 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

(a) DEDUCTION FOR EXPENSES.—Section 23 (a) (relating to deduction for expenses) is amended to read as follows:

"(a) EXPENSES.—

"(1) TRADE OR BUSINESS EXPENSES.—

"(A) IN GENERAL.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

. . . . . .

"(2) NON-TRADE OR NON-BUSINESS EXPENSES.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

. . . . . .

Revenue Act of 1942, which allows deductions for expenses "paid or incurred * * * for the management, conservation or maintenance of property held for the production of income." They concede, on brief, that the expenses involved had no connection with the "production or collection of income" as those words are used in section 23 (a) (2). There is no dispute over whether the claimed deductions were ordinary and necessary expenses.

Respondent, on brief, concedes that the trust property was "held for the production of income" as those words are [fol. 46] used in section 23 (a) (2), *supra*, but contends that nevertheless the expenses involved were not incurred or paid for managing, conserving, or maintaining the property so held, because, he argues, the expenses were proximately caused, not by such holding of the property, but by its distribution, and states more particularly that the management of the property of a trust does not embrace any act pertaining to the distribution or "settling up" of the trust estate.

The litigation in 40 B. T. A. 824, and 114 Fed. (2d) 217, arose in connection with property held for the production of income which the petitioners were managing, and, while the expenses of that litigation were paid as a result of the payment by petitioners as trustees of a bequest of $5,000,000 to Louise Clisby Wise, the sole purpose and object of the litigation and the proximate cause of the expenditure were to relieve the estate from the payment of the deficiency in income tax determined by the Commissioner, which was the subject matter of the litigation. The effort of petitioners in seeking, through this litigation, to give such relief to the estate was, in our opinion, obviously a factor in the conservation, management, and maintenance of the property of that estate, concededly held for the production of income, since in resisting the imposition of the tax the trustees were performing the required duty of protecting and defending the trust property in their hands against any claim or lien for the tax. Even if, on the facts presented, it could fairly be said that the distribution of the $5,000,000 bequest was the proximate cause of the expenses paid in [fol. 47] connection with the litigation, those expenses would then be essentially of the same character as those other expenses which are immediately hereinafter considered and would be deductible as expenses paid for the "management" of the property for the same reasons.

We hold that the expenses of the litigation are deductible from petitioners' gross income under section 23 (a) (2) of the Internal Revenue Code as added by section 121 of the Revenue Act of 1942.

As to the balance of the controverted expenses, amounting to $9,427.35, we are of the opinion that they are also deductible from the gross income of petitioners under the same statute. The subject matter with regard to which those expenses were incurred and paid involved problems arising out of the payment of a bequest to the University of North Carolina, the expiration of the trust, and distribution of its assets to the legatees, and such payment and distribution were made by the trustees as directed by the will and as a part of their duties in managing the trust property.

That those expenses incidental and necessary to the payment of the University of North Carolina legacy and the "settling up" of the trust estate through distribution of its property held here by the trustees for the production of income are deductible under section 23 (a) (2) of the Internal Revenue Code as added by section 121 (a) of the Revenue Act of 1942 is, in our opinion, clear; since one, if not the most vital duty imposed upon those trustees was to make proper distribution of such property, and in making it they were performing one of the principal functions of the [fol. 48] management of such property, since until that property reached the hands of the legatees and distributees the trustees were in complete control of it, and thus its management. "Management" is the act of managing; the manner of treating, directing, carrying on, or using, for a purpose; conduct; administration; guidance; control. (Webster's New Int. Dict.) The expenses were incurred and paid prior to the distribution and while the property still remained in the hands and in the complete control of the trustees.

This is not a case where the expenses in question were paid in the course of the administration of the estate and where the expenses would be deductible from the gross estate for estate tax purposes rather than from gross income. In the first place the trust here was a long term trust to endure for 21 years from September 23, 1916, and that the expenses in question were not incurred or paid in the course of the administration of the estate is further demon-

strated by the facts that the first payment of a legacy (the one to Louise Clisby Wise) with respect to which the expenses of the suit above mentioned were incurred and paid was in 1935; that the payment of the other legacy, to the University of North Carolina, with respect to which other of these expenses were incurred and paid, was made at or about the time of the expiration of the trust; and that the balance of the expenses of $25,867.31 was incurred and paid in connection with and as a result of the expiration of the trust and delivery of its assets to the legatees.

We conclude that the expenses paid in connection with the payment of the legacy to the University of North Carolina, [fol. 49] the expiration of the trust, and the distribution of the assets of the trust estate were "for the management, * * * of property held for the production of income" and we hold that the amount so expended is deductible from gross income of petitioners within the purview of section 23 (a) (2) of the Internal Revenue Code as added by section 121 (a) of the Revenue Act of 1942.

Reviewed by the Court.

Decision will be entered for the petitioners.

CONCURRING OPINION

KERN, J., concurring:

I concur in the result reached by the majority opinion only because I conceive that the management of the property of the estate embraced the proper disposition of it pursuant to the will of the decedent, and that the expenses of litigation arising out of the disposition of the property of the estate are consequently "ordinary and necessary expenses paid * * * for the management * * * of property held for the production of income," and deductible under section 121, quoted in the majority opinion. The mere fact that the purpose of the expenditure was to relieve the estate from the payment of the deficiency in income tax and to protect the property of the estate from any tax lien, does not, in my opinion, characterize the expenditure as one paid or incurred "for the management, conservation, or maintenance of property held for the production of income." See *John W. Willmott*, 2 T. C. 321, 326, 327.

SMITH, J., agrees with the above.

DISSENTING OPINION

DISNEY, J., dissenting:

The majority opinion first holds deductible, only under [fol. 50] section 121 of the Revenue Act of 1942, the expenses of contesting a deficiency which was determined by the Commissioner on the theory that taxable gain was realized through the payment of a legacy in securities which had appreciated in value. The reason given for such allowance is that the effort of the petitioner through the litigation to give relief to the estate was a factor in the conservation, management, and maintenance of the property of the estate, since in resisting the imposition of the tax the trustees were performing their duty in defending the trust property against the claim for tax. I can not agree with that conclusion. The mere fact that the payment of the deficiency would consume resources of the estate is no sufficient answer for allowing the deduction, for on such a theory any expense of any litigation, incurred by a trust or an individual, would be deductible merely because the litigation might have terminated in a judgment collectible out of the property or estate of the litigant, and without regard to whether the litigation concerned property held for the production of income. For instance, on the same theory, expenses of defending litigation for personal injuries caused by negligence would be deductible, though having no connection with properties held for the production of income. Regulations 103, as amended in the light of section 142 of the Revenue Act of 1942, in my opinion properly provide that expenditures incurred for the purpose of resisting a proposed additional assessment of taxes are not deductible, unless the taxes are on property held for the production of [fol. 51] income. The tax involved in the deficiency which was litigated was not a tax upon the property held by the estate, but upon gain realized in the act of paying a legacy. Clearly, I think, paying the legacy can not be called conservation, management, or maintenance of the property of the estate, within the terms of the statute, for the property of the estate was being disposed of instead of being maintained, managed, or conserved. In my view, the words were used in their usual significance, intended to allow the ordinary and necessary expense requisite to the proper preservation or use of the property involved, such, for example, as repairs and expenses of supervision; but I do not believe

that the deduction may properly be allowed merely because, to use the words of the majority opinion, "in resisting the imposition of the tax the trustees were performing the required duty of protecting and defending the trust property in their hands against any claim or lien for the tax." This is not a question of the duty of the trustees under the trust instrument, but one as to whether ordinary and necessary expenses were paid "for the management, conservation, or maintenance of property" held for the production of income, and I can not subscribe to the idea that to litigate any question which might result in a judgment collectible out of that property is to manage, conserve, or maintain it, within the intendment of the statute. I therefore think that the expense of litigation over the deficiency does not come within the statute.

[fol. 52] Nor can I agree that the expenses for services in connection with the payment of the legacy to the University of North Carolina and "other problems resulting from the expiration of the trust and delivery of its assets to the legatees," as the majority opinion expresses the facts, are deductible under the statute. The majority opinion allows these also, on the theory that in distributing the property under the trust instrument the trustees were managing it. Apparently, conservation or maintenance of the property is not relied upon in the majority view. Again, however, I note that Regulations 103, amended to cover section 121 of the Revenue Act of 1942, provides, as to expenditures of executors or administrators, that expense incurred "in distributing the remaining assets to the beneficiaries or in conserving the assets for ultimate distribution to the parties entitled thereto are not deductible under this section." The same logic applies to distributions by trustees. I do not think that it was the intent of the statute to so broaden the meaning of the word "management" as to include expenses of distributing an estate. Not only is the statute providing for a deduction to be strictly construed, but also ordinary significance of the word must be assumed. I note that *In re Knight's Estate*, 208 N. Y. S. 822, involved trustees required by will to manage realty. It was held, "The word 'manage' implies the supervision, maintenance, and care of the premises, the making of necessary repairs, and the payment of taxes and water rents," and therefore that [fol. 53] these duties, not being upon the trustees after the property had been leased for a long period, the trustees

were not entitled to commissions upon the rents. We think the above quotation is a fair definition of "manage," with reference to the property of an estate and that the term does not connote such duties as distributing the property under a will or trust instrument. Indeed, the distribution and winding up of an estate or trust, through it may have to do with property included in the estate, is in a very real sense merely the performance of a legal function or duty under the will or trust instrument, not of the same character as the actual handling or dealing with the property itself. Distribution would be necessary, though only cash in hand was involved. Such performance of general administrative duty is, in my opinion, sufficiently distinct from the management or even the management, conservation, or maintenance of property in the usual and ordinary sense, as to require the conclusion that Congress did not intend to include it within the statutory expression. The statute does not provide for the expenses of management of an estate or trust, but "of property." To enlarge the meaning of the word, as is done by the majority opinion, is, as I see it, judicial legislation; and if such effect is desirable, I think the matter should be left to Congress. In my opinion, section 121 does not, as the majority opinion holds, cover the situation.

HARBON, J., agrees with this dissent.

[fol. 54] IN THE TAX COURT OF THE UNITED STATES

Washington

Docket No. 109384

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Received in Docket Section Oct. 8, 1943, 4:09 P. M. Appeals Division Off. Chief Counsel, Bureau Internal Rev.

Received Oct. 1, 1943. Counsel, New York Division, New York City Office.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated October 8, 1943, it is

Ordered and decided: That there is no deficiency in income tax for the calendar year 1940.

[Signed] John A. Tyson, Judge.

Entered Oct. 8, 1943.

[fol. 55] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1944

No. 90

(Argued October 12, 1944. Decided November 10, 1944)

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

against

WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, as Trustees under the Will of Mary Lily (Flagler) Bingham, Respondents

Before L. Hand, Augustus N. Hand and Chase, Circuit Judges

Petition of the Commissioner of Internal Revenue to review an order of the Tax Court of the United States determining that there was no deficiency in federal income tax liability of the respondents William R. Kenan, Jr., and Lawrence C. Haines, as Trustees under the Will of Mary Lily (Flagler) Bingham for the calendar year 1940. Reversed.

[fol. 56] Samuel O. Clark, Jr., Assistant Attorney General, Sewall Key, J. Louis Monarch and L. W. Post, Special Assistants to the Attorney General, for the petitioner, Commissioner of Internal Revenue.

George E. Cleary, Attorney and counsel for respondents William R. Kenan, Jr., and Lawrence C. Haines, as Trustees under the Will of Mary Lily (Flagler) Bingham.

AUGUSTUS N. HAND, Circuit Judge:

The question before us is whether $25,867.31 paid in the year 1940 by the respondents as trustees under the will of Mary Lily (Flagler) Bingham were "ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income" and thus deductible in computing their income tax under Section 23 (a) (2) of the Internal Revenue Act of 1942 which amended Section 23 (a) by adding subdivision (2) *supra*. The Tax Court allowed the de-

duction and the Commissioner of Internal Revenue appeals. In our opinion the Commissioner is right and the decision of the Tax Court must be reversed.

The $25,867.31 objected to by the Commissioner, but allowed by the Tax Court, were part of the sum of $210,741.93 paid by the trustees as expenses all of which were allowed by the Tax Court and all but the $25,867.31 were stipulated by the parties to have been "ordinary and necessary expenses paid during the tax year for the production or collection of income or for the management, conservation or mainatenance of property held for the production of income."

[fol. 57] The items constituting the $25,867.31 were all fees and charges paid to the attorneys for the trustees in the following amounts and relating to the following services:

(1) Items amounting to $16,439.96 represented fees and charges paid by the trustees to their attorneys in connection with the litigation as to income taxes before this court dealt with in our opinion reported in *Kenan Jr.* v. *Commissioner*, 114 F. (2d) 217. The question there decided against the trustees was whether a distribution by the trustees to a legatee in payment of $5,000,000 upon her reaching forty years of age resulted in a taxable gain to the trust where the securities distributed in payment had appreciated in value during the period during which they were held by the trustees. We there held that the appreciation was taxable as a capital gain.

(2) Items amounting to $780.85 represented fees and charges of the trustees' attorneys for services in connection with the annual payment of $75,000 by the trusees during the continuance of the trust to the University of North Carolina.

(3) The remaining items aggregating $8,646.50 consisted of fees and charges of the trustees' attorneys paid by the trustees for services in respect to the tax and other problems resulting from the expiration of the trust and delivery of the corpus to the legatees in remainder. The amount paid for fees included in (3) was for the following services as set forth in the stipulation of the parties:

> "For services in considering the tax problems resulting from the expiration of the trust, advice as to the present status of the

Trust for tax purposes, and as to various methods whereby the various properties of [fol. 58] the Trust might be continued as a single unit in the future; investigation of various questions of law and preparation for the Trustees of a memorandum in which the recommendation was made that the stocks of certain companies owned by the Trust be placed in one or more Voting Trusts; formation of Voting Trusts; advice relative to indebtednes owed by two of the principal corporations; preparation of documents; and assisting the Trustees in delivery of the assets of the Trust to the legatees ..... $8,500.00"

It is the contention of the Commissioner that all of the foregoing expenses were paid by the trustees in connection with the distribution of the property to legatees under the will of Mary Lily (Flagler) Bingham, were in the nature of capital expenditures and were not deductible under Section 23 (a) (2) of the Internal Revenue Act as amended. A majority of the Tax Court held that the above legal fees and charges were necessary expenses paid "for the management, conservation or maintenance of property held for the production of income" and, as such, were properly deductible.

The payment of $16,439.96 made by the trustees for legal services in connection with the litigation of *Kenan, Jr.* v. *Commissioner*, 114 F. (2d) 217, in which they had sought to establish that the appreciation in value of the securities turned over to the legatee as a part payment of the legacy of $5,000,000 bequeathed under the will of Mary Lily (Flagler) Bingham did not represent a "taxable" gain to the estate, cannot be regarded a payment for the "management, conservation or maintenance of property held for the production of income." It was not made as a recompense for management or maintenance of the trust property since that property was not held for the production of income but was [fol. 59] in the hands of the trustees ready for distribution. Taxes laid upon it had nothing to do with the production of taxable gain or ordinary income. The expense of contesting the taxes had no relation to the "management, conservation or maintenance of property held for the production of in-

come." The contest was not in order to produce income and the expenditure accordingly had no bearing upon such a purpose. To be deductible as expenses for management they must relate to the production of income or to the maintenance of property held for that purpose. They were not deductible when incurred merely to prevent the incidence of taxes which neither affected the yield of investment capital nor its appreciation.

In *Stoddard* v. *Commissioner*, 141 F. (2d) 76, we held that a payment to accountants for services in contesting income taxes assessed against an individual were not deductible under Section 23 (a) (2). Fees paid to lawyers for a similar object plainly are not different. The Court of Appeals of the First Circuit denied such a deduction in *Higgins* v. *Commissioner*, 143 F. (2d) 654, and the Court of Appeals of the Sixth Circuit in *Hord* v. *Commissioner*, 143 F. (2d) 73, rendered a decision to much the same effect. It does not seem reasonable to suppose that litigating the question whether a taxable gain in the trust securities had arisen was to manage or conserve or maintain the securities which had appreciated in value.

The items of $780.85 for services in connection with the annual payments to the University of North Carolina were not deductible as expenses. They had no relation to the production of income, or to the conservation of property held for that purpose. They only related to legal advice in respect to distribution to a legatee, and not to the management of any property held for the production of income. Only by an extremely liberal interpretation of an exemption clause, which must be construed not broadly but strictly, [fol. 60] could such services be regarded as coming within the meaning of the word "management."

The items aggregating $8,646.50 were likewise paid for services connected with the distribution of the trust estate and not with the production of income or the management of property held for the production of income. The services were performed after the trust had ended and only a distribution of the corpus to the legatees under the will remained to be effected. Advice in keeping the trust assets together and forming voting trusts for that purpose and work in setting up such voting trusts involved personal services rather than management of the trust estate by trustees. Any other payments for services which might possibly be thought to come within Section 23 (a) (2) are

not sufficiently disclosed in the record to justify regarding them as deductible for income tax purposes.

In view of the foregoing, the order of the Tax Court is reversed and the proceeding remanded.

[fol. 61] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 27th day of November one thousand nine hundred and forty-four.

Present: Hon. Learned Hand, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, et al., Trustees, etc., Respondents

Appeal from the Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed and the proceeding remanded.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 62] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Commissioner of Internal Revenue, v. Trust U/W of Mary Lily (Flagler) Bingham, et al., Trustees, etc. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Nov. 27, 1944. Alexander M. Bell, Clerk.

[fol. 63] UNITED STATES OF AMERICA,
Southern District of New York:

I, Alexander M. Bell, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 62, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Commissioner of Internal Revenue, Petitioner, against Trust U/W of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Respondents, as the same remain of record and on file in my office.

In Testimony Whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 18th day of January, in the year of our Lord one thousand nine hundred and forty-five, and of the Independence of the said United States the one hundred and sixty-ninth.

Alexander M. Bell, Clerk. (Seal.)

[fol. 64] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed March 12, 1945

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 49,385. U. S. Circuit Court of Appeals, Second Circuit. Term No. 932. Trust u/w of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Petitioner, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed February 9, 1945. Term No. 932, O. T. 1944.

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CLERK

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 932

Trust u/w of MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, Trustees,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT OF PETITION.

GEORGE E. CLEARY,
Counsel for Petitioner.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

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I. The Circuit Court of Appeals erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for the management of income-producing property deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a pure question of fact as to which the decision of the Tax Court should have been regarded as final	12
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Supreme Court of the United States

OCTOBER TERM, 1944.

No. .....

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, Trustees,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

TO THE HONORABLE THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The above named Petitioner prays that a Writ of Certiorari be issued to the United States Circuit Court of Appeals for the Second Circuit to review a judgment of that Court rendered in the above cause on November 27, 1944 (R. 59) reversing a decision of the Tax Court of the United States which had found that there was no deficiency in the Federal Income Tax of Petitioner for the calendar year 1940 (R. 54). The Tax Court had approved the deduction under Section 23(a)(2) of the Internal Revenue Code of certain expenses for legal services and the question is whether the Circuit Court of Appeals was in error in reversing this decision.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. A., §347(a)).

The Opinions of the Courts Below.

The opinion of the Tax Court (R. 36) is reported in 2 T. C. 853. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 55) is reported in 145 F. (2d) 568.

Statute Involved.

The statute is Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798, which amended Section 23(a) of the Internal Revenue Code by adding a subdivision (2). The relevant portions of Section 121 read as follows:

"Sec. 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

(a) *Deduction for Expenses.*—Section 23(a) (relating to deduction for expenses) is amended to read as follows:

'(a) *Expenses.*—

'(1) *Trade or Business Expenses.*—

'(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business,

of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * * *

'(2) *Non-trade or Non-business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.'*

* * * * * *

(d) *Taxable Years to Which Amendments Applicable.*—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938.

(e) *Retroactive Amendment to Prior Revenue Acts.*—For the purposes of the Revenue Act of 1938 or any prior revenue Act the amendments made to the Internal Revenue Code by this section shall be effective as if they were a part of such revenue Act on the date of its enactment."

Summary Statement of Matter Involved.

Petitioner maintains that it was entitled for the year 1940 to deduct from gross income under Section 23(a)(2) of the Internal Revenue Code certain legal fees and disbursements as expenses paid "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." The Tax Court held on the facts of this case that such deductions were allowable. The Circuit Court of Appeals, without referring to the decision in *Dobson* v. *Commissioner,* 320 U. S. 489 (1943), reversed the Tax Court

* This provision is made applicable to trusts by Section 162, Internal Revenue Code.

on the ground that in its opinion these expenses were not sufficiently related to the production of income or the management of income producing property to come within the statute.

Facts.

All of the facts were stipulated in the Tax Court (R. 14 to 35).

Mary Lily (Flagler) Bingham died on July 27, 1917, leaving a Will executed December 23, 1916 (R. 15). The Will (R. 19-35), after providing for certain devises of real estate and specific bequests of jewelry, provides for the conveyance to Trustees of all the residue of the property. The Trustees were directed to pay to various parties some $536,000 in cash legacies and to deliver to other parties 40,250 shares of stock of various Standard Oil Companies, as soon as compatible with the administration of the estate and the carrying out of the Testator's wishes with reference to the hotel and railroad properties mentioned in item NINTH of the Will. The Will also provided (R. 25) for the payment of $200,000 annually to a niece of the Testator until that niece attained the age of 40 years, when she was to be paid $5,000,000 in cash or securities at the discretion of the Trustees, if compatible with the interests of the estate. The Will also provided (R. 26) that the Trustees should pay $75,000 annually to the University of North Carolina during the continuance of the Trust and at the expiration thereof should pay to the University such a sum in cash as would produce an annual income of $75,000.

Item NINTH of the Will (R. 27) provided that all the rest of the estate should be held in trust for 21 years from the date of the Will for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties and the properties

held by subsidiary companies. The Trustees were given broad powers to administer the trust for this purpose. The Will provided for compensation to the Trustees of $50,000 a year (R. 39).

At the end of 21 years from the date of the Will the Trustees were to divide the property then in their hands into three equal parts and transfer these to the testator's two sisters and brother (R. 39).

The Trustees of this long-term trust filed an income tax return for the year 1940, showing a tax of $312,629.27, which was duly paid (R. 15).

The Commissioner of Internal Revenue determined a deficiency in income tax of $160,815.10 by disallowing the following deductions which had been claimed on the tax return:

Compensation of Trustees	$141,369.86
Office salaries	34,934.30
Office supplies and expenses	2,448.97
Petty cash	1,722.89
Office rent, net	3,419.10
Tax and financial services	498.75
Legal expenses	25,867.31
Miscellaneous	480.75
Total deductions disallowed	$210,741.93

(R. 12).

Upon the Petitioner's petition to the Tax Court, the Commissioner stipulated that, except for the item of $25,867.31 of legal expenses, the expenses originally disallowed were ordinary and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation or maintenance of property held for the production of income (R. 16). Such items were therefore deductible under Section 23(a)(2) of the Internal Revenue Code, which was added by Section 121, Revenue Act of 1942, retroactively applicable to the year 1940.

The legal fees and expenses of $25,867.31 which remained in controversy were as follows:

(1) $16,439.96 was incurred in contesting a deficiency in income tax of the trust of $365,687.12, asserted for the year 1935. This was litigated in the Board of Tax Appeals (*William R. Kenan, Jr., et al.*, 40 B. T. A. 824, 1940) and the Circuit Court of Appeals for the Second Circuit (*Kenan* v. *Commissioner*, 114 F. (2d) 217, 1940). In this proceeding, the Courts sustained the Commissioner, in holding that the Trustees realized a gain from the sale or exchange of capital assets by exercising their power to pay partly in securities at market value the bequest of $5,000,000 payable to the testator's niece when she reached age 40 or as soon thereafter as compatible with the interests of the estate. The securities so delivered had appreciated in value since acquisition by the Trustees and it was held that such delivery in satisfaction of this bequest, although within the discretionary powers of the Trustees, was nevertheless a sale or exchange of the securities, giving rise to capital gain (R. 40).

(2) $780.25 was for services and disbursements in connection with the payment at the termination of the trust of the above mentioned legacy to the University of North Carolina (R. 41).

(3) The remaining $8,646.50 of the total of $25,867.31 in legal fees and charges paid by the trust in 1940 was for services rendered in respect of the tax and other problems resulting from the expiration of the trust and the delivery of its assets to the ultimate beneficiaries (R. 41).

The Commissioner conceded in his brief in the Tax Court that the trust property was held for the production of income, as those words are used in Section 23(a)(2) of the Internal Revenue Code (R. 45) and there was no claim that the expenses were not ordinary and necessary (R. 45).

The Decisions Below.

The Tax Court, on the facts of this case, held that the legal expenses were deductible under Section 23(a)(2) (R. 36-54). It first refused to allow the expenses as expenses of carrying on a trade or business (R. 44) and no appeal was taken from this part of the decision. It then held that the $16,439.96 expense of the income tax litigation was deductible because it found that the effort of these trustees to relieve the estate from the payment of this tax was a factor in the conservation, management and maintenance of the property of that estate, concededly held for the production of income (R. 46). Two judges who concurred in the result did not agree on this point (R. 49). The Tax Court then found, two judges dissenting (R. 49), that all of the expenses (including the expense of the tax litigation) were incurred by the trustees in the performance of one of the principal functions of the management of such property while they were in complete control of it, and hence were deductible as expenses for the management of property held for the production of income (R. 47-48).

The Circuit Court of Appeals reversed this decision (R. 55-59). The Court mentioned, but did not pass upon, the Commissioner's contention that the expenses were in the nature of capital expenditures (R. 57). It based its decision on the ground that the expense of contesting the taxes "had no relation" to the management, conservation or maintenance of property held for the production of income, because the contest was not to produce income and did not affect the yield of investment capital or its appreciation (R. 57, 58); it said that the expense of $780.85 for services in connection with the payment to the University of North Carolina "had no relation" to the production of income, or to the conservation of the property held for

that purpose because it had to do with distribution and not with management (R. 58); it said that the remaining expenses of $8,646.50 were likewise paid in connection with distribution and not with the production of income or the management of the property, were paid for services performed after the trust had ended, and that the advice "involved personal services rather than management of the trust estate" (R. 58).

The heart of the difference between the Tax Court and the Appellate Court was that the former found that these expenses were directly connected with or related to the management of the property of this trust, whereas the latter found that such expenses bore "no relation" to such management.

Questions Presented.

1. Under the principles established in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), did the Circuit Court of Appeals err in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for management of income producing property deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management?

2. Did the Tax Court make a clear cut mistake of law in holding that legal expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income producing property to a beneficiary were expenses for the management of the trust property?

Reasons Relied on for Allowance of the Writ.

The writ of certiorari should be issued because the Circuit Court of Appeals violated the principles as to appellate procedure established in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), and *Commissioner* v. *Scottish American Investment Co., Ltd.*, 65 S. Ct. 169 (1944), by reversing the Tax Court on a question of fact as to the relationship of the contested expenses to the management of trust property, concededly held for the production of income. The Tax Court, on the basis of the facts of this case, directly found that the required relationship existed. The basic reason stated by the Circuit Court of Appeals for its reversal was that such expenses bore "no relation" to the management of the trust property. The Appellate Court thus differed with the Tax Court as to a pure factual inference or conclusion. Such a decision is of little value as a precedent in other cases. Review by the appellate courts of cases of this kind will require examination, analysis and the drawing of distinctions as to a body of precedents where differences in result depend primarily on differences of fact or factual conclusions.

The decision below should be reviewed in order to define more sharply the function of the Appellate Courts on appeals from the Tax Court and to discourage appeals in the large class of cases where the result depends on the relationship in a particular factual setting of the expenses claimed to either the carrying on of a trade or business or to the production of income or the management of property held for the production of income.

The decision below should be reviewed because the Circuit Court of Appeals erroneously held as a matter of law that a trust could in no event deduct as an expense

for management of property held for production of income either the expenses of settling up the trust and distributing its assets to the beneficiaries or the expenses of contesting income tax liabilities for prior years. The deductibility of particular expenses in particular cases turns on pure questions of fact. The Tax Court made no obvious mistake of law in holding that the expenses were deductible under the facts of this case. Its decision was not without rational basis. Its decision was supported by substantial evidence. The case involves an important question of Federal law, affecting every trust subject to Federal income tax, which was wrongly decided below and which has not been but should be settled by this Court.

Wherefore, petitioner respectfully prays that a writ of certiorari issue under the Seal of this Court to review the decision of the Circuit Court of Appeals for the Second Circuit in the above case, and that said decision be reversed.

Trust U/W of Mary Lily (Flagler) Bingham,
Messrs. William R. Kenan, Jr., and
Lawrence C. Haines, Trustees,
Petitioner,

By GEORGE E. CLEARY,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION.

Questions Presented, Statement of Case, etc.

The statement of questions presented, the statement of the case, and the statutes involved will be found in the petition.

Specification of Errors and Summary of Argument.

1. The Circuit Court of Appeals erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for the management of income-producing property, deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a pure question of fact as to which the decision of the Tax Court should have been regarded as final.

2. The Tax Court made no clear-cut mistake of law in holding that expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income-producing property to a beneficiary were expenses for the management of the trust property.

ARGUMENT.

I.

The Circuit Court of Appeals erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for the management of income-producing property deductible under Section 23(a)(2), on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a pure question of fact as to which the decision of the Tax Court should have been regarded as final.

In this case it was conceded that the trust property was "held for the production of income" as those words are used in Section 23(a)(2) (R. 45, 46). There was no dispute over whether the claimed deductions were ordinary and necessary expenses (R. 45). Neither of the lower courts regarded the expenses as capital expenditures. It was undisputed that the trust was a long term trust with large assets and income and that the expenses were incurred by the Trustees in carrying out their duties under the Will creating the trust (R. 15). The Tax Court found that the expenses were incurred by the Trustees as an important part of their duties and functions in managing the trust property while they were in complete control of it, that such expenses were directly related to such management and hence were deductible (R. 46-48).

The Circuit Court of Appeals differed with the Tax Court as to the relationship of the expenditures to the management of the income-producing property and reversed on the ground that such expenses bore "no relation" to the management of the income-producing property (R. 57, 58).

Without at this point going into details as to the expenses deducted, it is submitted that the reversal of the Tax Court's decision by the Circuit Court of Appeals was erroneous under the principles set forth in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943) and *Commissioner* v. *Scottish American Investment Co. Ltd.*, 65 S. Ct. 169 (1944) because the relationship of these expenses to the management of the income-producing property held by these trustees is purely a question of fact. The Tax Court's determination of such fact, if supported by substantial evidence, is final.

Every case in which the deduction of expenses is claimed involves a question of fact as to whether such expenses are incurred "in carrying on any trade or business" if the claim is made under Section 23(a)(1) or are incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income" if the claim is made under Section 23(a)(2). Where, as in this case, the controversy is one as to *the relationship* in the particular case of the expense to the business, the income, or the income-producing property, the factual inference or conclusion of the Tax Court as to whether or not such relationship is sufficiently close to warrant the deduction is obviously of little value as a precedent in other cases.

There is no rule of law which indicates that the Tax Court's decision in this case was without rational basis. The Tax Court made no clear-cut mistake of law. It was not unreasonable for the Tax Court to conclude that these expenses of this trust were deductible under Section 23(a)(2) when it was established by substantial evidence that the trust property was held for the production of income, that the expenses were ordinary and necessary expenses and were incurred by the trustees in carrying

out the provisions of the trust at a time when the property was still under their complete control.

In *Commissioner* v. *Heininger*, 320 U. S. 467, 475 (1943), the Court said, in a controversy as to the deduction of business expenses:

> "Whether an expenditure is directly related to a business and whether it is ordinary and necessary are doubtless pure questions of fact in most instances. Except where a question of law is unmistakably involved a decision of the Board of Tax Appeals on these issues, having taken into account the presumption supporting the Commissioner's ruling, should not be reversed by the federal appellate courts. Careful adherence to this principle will result in a more orderly and more uniform system of tax deductions in a field necessarily beset by innumerable complexities".

In this case the Court reversed the Board of Tax Appeals solely because it had proceeded upon a mistaken conviction that denial of the deduction claimed was required as a matter of law.

In *McDonald* v. *Commissioner*, 65 S. Ct. 96 (1944), involving the deductibility of campaign expenses of a judge seeking election, the Court affirmed a decision of the Tax Court denying the deduction. The opinion states that the Court would not be inclined to displace the views of the Tax Court with its own views in a case of this kind. The Court said:

> "We are therefore relieved from discussing the numerous cases in which the Tax Court or its predecessor, the Board of Tax Appeals, allowed or disallowed deductions and their bearing on the situation before us. To do so involves detailed analysis

> of the special circumstances of various 'businesses' and expenses incident to their 'carrying on.' We shall not enter this quagmire of particularities."

In the dissenting opinion, it is said

> "Were the expenses incurred in an effort to produce income? Were these expenses, or part of them, 'ordinary and necessary' in connection with that effort? These are in most instances purely questions of fact and in cases such as this are to be determined by the tax court."

The present case is one of a class to which is fully applicable the following statement of the Court in *Commissioner v. Scottish American Investment Co., Ltd.*, 65 S. Ct. 169 (1944):

> "Moreover, this case exemplifies one type of factual dispute where judicial abstinence should be pronounced. The decision as to the facts in this case, like analogous ones that preceded it, is of little value as precedent. The factual pattern is too decisive and too varied from case to case to warrant a great expenditure of appellate court energy on unraveling conflicting factual inferences."

If the decision below is allowed to stand, taxpayers and the Commissioner will be encouraged to ask appellate courts to review decisions of the Tax Court as to the deduction of expenses where the sole issue is the relationship of the particular expense under the facts of the particular case to the business carried on, the income produced or the income-producing property held. For a period of years, while these cases are pending, the Tax Court will be hampered in making a systematic, orderly and uniform application of the statutory provisions to the facts of particular cases.

For these reasons, it is submitted that the action of the Circuit Court of Appeals in reversing the Tax Court's decision in this case was erroneous and contrary to the principles as to judicial review of Tax Court decisions established by this Court.

II.

The Tax Court made no clear-cut mistake of law in holding that expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income-producing property to a beneficiary were expenses for the management of the trust property.

Section 23(a)(2) allows the deduction of ordinary and necessary expenses paid or incurred during the taxable year

(1) "for the production or collection of income",

(2) "or for the management, conservation or maintenance of property held for the production of income".

The amendment obviously does more than allow the direct expenses of producing or collecting current income, which are covered by the first part of the clause. The statute allows in addition the deduction of expenses for the management, conservation or maintenance of income-producing property.

The Committee Reports show that Congress intended that the section should be broadly applied to allow the deduction of ordinary and necessary expenses incurred in connection with investment income and property, thus curing the inequity of the prior statute made manifest by the decision in *Higgins* v. *Commissioner*, 312 U. S. 212

(1941) and conforming to the broad basic policy of "taxation on net, not on gross income," (dissenting opinion *McDonald* v. *Commissioner*, 65 S. Ct. 96, 1944).

In House Report No. 2333, 77th Congress, Second Session, pages 46, 75, the Ways and Means Committee said with respect to this provision

> "Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable. • • •
>
> "Ordinary and necessary expenses so paid or incurred are deductible under section 23(a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term 'income' for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income."
>
> • • • • • •
>
> "Expenses, to be deductible under section 23(a)(2) must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income or to the management, conservation or maintenance of property held for that purpose."

The report of the Senate Finance Committee is to the same effect. (Senate Report No. 1631, 77th Congress, Second Session, pages 87-88).

The statutory provision in question is not an exemption clause, as it was characterized by the court below (R. 79), but a deduction clause covering items which "can conveniently come within" its "clear provisions" (*McDonald* v. *Commissioner*, 65 S. Ct. 96, 1944).

In view of these principles we submit that the Tax Court made no clear-cut mistake of law in allowing the disputed items as deductions under the facts of this case.

The taxpayer was not an individual, but a long-term trust, holding property for the production of income. There was no claim that the expenses were not ordinary and necessary. It was not denied that everything the trustees did was pursuant to their powers and duties under the trust instrument and that the expenses were incurred while the property was under their complete control. The Commissioner had conceded that the trustees' compensation, the office salaries, the rent and other expenses were fully deductible with no attempt to allocate any part of these to activities in connection with winding up the trust or distributing its assets, or the income tax litigation.

In this setting the Tax Court approved the deduction as expenses of management of income-producing property of the following items:

1. Deduction was allowed of $16,439.96 of legal fees and charges paid in contesting a 1935 income tax deficiency of $365,687.12. With respect to this deduction the Tax Court said

> "The effort of petitioners in seeking, through this litigation, to give such relief to the estate (relief from payment of the deficiency in income tax) was,

> in our opinion, obviously a factor in the conservation, management and maintenance of the property of the estate concededly held for the production of income, since in resisting the imposition of the tax the trustees were performing the required duty of protecting and defending the trust property in their hands against any claim or lien for the tax" (R. 46).

2. This same item of $16,439.96, and the additional expenses of $9,427.35, were allowed as deductions by the Tax Court on the ground that they were all expenses paid for the management of the trust property. The additional expenses involved problems arising out of the payment of a bequest to the University of North Carolina, the expiration of the trust and the distribution of its assets to the legatees (R. 47).

The Tax Court said

> "Such payment and distribution were made by the trustees as directed by the will and as a part of their duties in managing the trust property" (R. 47).

It further said that the expenses of "settling up" the trust estate were deductible

> "since one, if not the most, vital duty imposed on those trustees was to make proper distribution of such property, and in making it they were performing one of the principal functions of the management of such property, since until that property reached the hands of the legatees and distributees the trustees were in complete control of it and thus its management" (R. 47, 48).

The concurring judges agreed on the ground that "the management of the property of the estate embraced the proper disposition of it pursuant to the will of the decedent" (R. 49).

The Circuit Court of Appeals reversed on the ground that expenses of contesting taxes and settling up the trust had "no relation" to the management, conservation or maintenance of property held for the production of income (R. 57, 58).

The Circuit Court of Appeals was wrong in laying down a rule of law that the expenses of contesting an income tax deficiency for prior years could never be an expense for the management of income-producing property even where, as here, the taxpayer was a trust holding income-producing property and the transaction in controversy was a transfer of income-producing property to a beneficiary held to give rise to a taxable gain to the trust. It is for the Tax Court to determine from the facts of the particular case whether or not such an expense is an ordinary and necessary expense for management of property held for the production of income.

The three cases cited by the Circuit Court of Appeals on this point, in all of which the Tax Court or its predecessor was affirmed as to this question, established no rule of law. In *Stoddard* v. *Commissioner*, 141 F. (2d) 76 (C. C. A. 2nd, 1944), the decision simply was that an individual taxpayer could not deduct expenses of contesting prior years' income taxes where there was no proof of the nature of the controversy. (See 47 B. T. A. 584, 588.) In *Higgins* v. *Commissioner*, 143 F. (2d) 654 (C. C. A. 1st, 1944), the Court refused to hold that the statute in all cases allowed as expenses of management the deduction of expenses in connection with income tax controversies, the court's view being that the deductibility of such an item was a question of fact in each case. In *Hord* v. *Commissioner*, 143 F. (2d) 73 (C. C. A. 6th, 1944), the expenses disallowed were with respect to a controversy over an undescribed income tax refund for 1928 and the determination of an undescribed deficiency for 1929. In none of these cases did the proof

submitted establish any connection between the expenses claimed and the management of income-producing property.

The Tax Court, although strictly requiring taxpayers to prove the nature of the expenses and their connection with the production of income or the management of income-producing property, has in other cases allowed the deduction of expenses of income tax controversies particularly where, as in this case, the controverted transaction was one which itself gave rise to taxable income (*Manning*, 3 T. C. 853, 1944). The Tax Court's view is that if the original transaction was proximately related to the production or collection of income, any litigation arising out of that transaction involving its tax consequences would also proximately relate to the production or collection of income", and the fees and expenses in connection with such litigation would be deductible. This view was confirmed in *Estate of F. C. Bartholemew*, 4 T. C. No. 44 (1944) and is supported by the reasoning in *Kornhauser* v. *United States*, 276 U. S. 145 (1928).

The Circuit Court of Appeals was also wrong in laying down a rule of law that the expenses of a trust in connection with the winding up of the trust and the distribution of its assets can never be an expense of the management of trust property. That too is a question of fact in each particular case as to which the determination of the Tax Court should be final.

The establishment of a long-term trust is one common method employed for the management of income-producing property. In every such case, some expense is involved in connection with the winding up of the trust, the distribution of the trust property and the accounting to the beneficiaries at the termination of the trust. The trustees and their employees, accountants and attorneys must devote

time and attention to this most important function and activity. How can it be said that there is no rational basis for regarding these services as a part of the management of the trust property? How can it be held as a matter of law that expenses incurred in carrying out this trust duty of distributing the trust property bear "no relation" to the management of the trust property?

The view of the Circuit Court of Appeals seems to be that no expense is deductible under Section 23(a)(2) unless it is incurred for the specific purpose of producing income through increasing yield or causing appreciation in value of the property held (R. 58). Congress adopted no such impracticable rule. By the plain terms of the statute, in addition to the expenses for the production or collection of income, there is deductible the ordinary and necessary expense incurred for the management, conservation or maintenance of income-producing property.

Under the view adopted below, the Commissioner would be obliged in every case to analyze the activities of trustees and their employees, and to deny as a deduction any part of the trustees' compensation, the salaries paid to employees and the fees paid to accountants and attorneys which had to do with the settling up of the trust and the distribution of its assets, or with income tax controversies. Taxpayers would have to prove that every deduction claimed for trustees' fees, investment management fees, office expense, employees' salaries and fees to attorneys and accountants, incurred in connection with the management of income-producing property, was incurred for the specific purpose of producing or collecting present or future income, and had nothing to do with income tax controversies or with winding up a trust. The statute would be construed and applied as if it allowed deductions only of expense "for the production or collection of income". The Congressional mandate that

in addition there was deductible expenses for the management, conservation or maintenance of income-producing property would in large measure be disregarded.

In every case, of course, a determination of fact must be made as to whether the deduction claimed bears a reasonable and proximate relationship to the production or collection of income or to the maintenance, management or conservation of income-producing property, or to carrying on a trade or business. It may be difficult in many cases to draw the line, but it is respectfully submitted that it is the function of the Tax Court to determine in particular cases where the line should be drawn and that the appellate courts should not concern themselves with such questions of fact.

Conclusion.

For the foregoing reasons it is respectfully submitted that the petition for writ of certiorari to the Circuit Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

GEORGE E. CLEARY,
Counsel for Petitioner.

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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 932.

Trust u/w of MARY LILY (FLAGLER) BINGHAM, Messrs. WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, Trustees,

Petitioners,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS.

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Petitioners.

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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 932.

Trust u/w of MARY LILY (Flagler) BINGHAM, Messrs. William R. Kenan, Jr., and Lawrence C. Haines, Trustees,

Petitioners,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS.

This is a proceeding to review a judgment of the Circuit Court of Appeals for the Second Circuit which reversed a decision of the Tax Court of the United States. The Tax Court had found that there was no deficiency in the Federal income tax of petitioners for the calendar year 1940. Petition for writ of certiorari was granted on March 12, 1945 (R. 47).

Opinions Below.

The opinion of the Tax Court (R. 26) is reported in 2 T. C. 853. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 41) is reported in 145 F. (2d) 568.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. A., §347(a)).

Statute Involved.

The statute involved is section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798, which amended section 23(a) of the Internal Revenue Code by adding a new subdivision (2). The relevant portions of section 121 read as follows:

"Sec. 121. Non-Trade or Non-Business Deductions.

"(a) *Deduction for Expenses.*—Section 23(a) (relating to deduction for expenses) is amended to read as follows:

"'(a) *Expenses,*—

'(1) *Trade or Business Expenses.*—

'(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

• • • • • •

'(2) *Non-Trade or Non-Business Expenses.*—In the case of an individual, all the ordinary and neces-

sary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.'

* * * * * *

"(d) *Taxable Years to Which Amendments Applicable.*—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938."

Section 162 of the Internal Revenue Code (26 U. S. C. A. §162) provides:

"The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual * * *" with exceptions not material here.

The relevant portions of the Reports of Congressional Committees with respect to this section are set forth in the Appendix to this brief at page 31, as are also the pertinent sections of Treasury Regulations 103, at page 36.

Statement of Case.

Petitioners maintain that they were entitled under section 23(a)(2) of the Internal Revenue Code to deduct from gross income for the year 1940 legal fees and disbursements aggregating $25,867.31 as expenses paid "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." The Tax Court held on the facts of this case that such deductions were allowable. The Circuit Court of Appeals, without pointing out any clear-cut mistake of law or referring to the decision in *Dobson* v.

Commissioner, 320 U. S. 489 (1943), reversed the Tax Court on the ground that in its opinion these expenses were not sufficiently related to the production or collection of income or the management of income-producing property to come within the statute.

Facts.

All of the facts were stipulated in the Tax Court (R. 10 to 25).

At all times, since prior to January 1, 1940, the taxpayers were the duly qualified and acting trustees of the trust created by the will of Mary Lily (Flagler) Bingham (R. 11).

Mary Lily (Flagler) Bingham died on July 27, 1917 (R. 10), leaving a will executed September 23, 1916 (R. 23). The will (R. 14), after providing for certain devises of real estate and certain specific bequests of jewelry, provides for the conveyance to trustees of all the residue of the property. The trustees were directed to pay to various parties some $536,000 in cash legacies and to deliver to other parties 40,250 shares of stock of various Standard Oil Companies, as soon as compatible with the administration of the estate and the carrying out of the testator's wishes with reference to the hotel and railroad properties mentioned in item NINTH of the will, hereinafter referred to. The will also provided (R. 18) for the payment of $200,000 annually to a niece of the testator until that niece attained the age of 40 years, when she was to be paid $5,000,000 in cash or securities at the discretion of the trustees, if compatible with the interests of the estate. The will also provided (R. 19) that the trustees should pay $75,000 annually to the University of North Carolina

during the continuance of the trust and at the expiration thereof should pay to the University such a sum in cash as would produce an annual income of $75,000.

Item NINTH of the will (R. 19) provided that all the rest of the estate should be held in trust for 21 years from the date of the will for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties and the properties held by subsidiary companies. The trustees were given broad powers to administer the trust for this purpose. The will provided for compensation to the trustees of $50,000 a year which should also cover their services as executors (R. 23).

At the end of 21 years from the date of the will the trustees were to divide the property then in their hands into three equal parts and transfer these to the testator's two sisters and brother in equal shares (R. 20).

The trustees of this long-term trust filed an income tax return for the year 1940, showing a tax of $312,629.27, which was duly paid (R. 11).

The Commissioner of Internal Revenue determined a deficiency in income tax for 1940 of $160,815.10 by disallowing the following deductions which had been claimed on the tax return:

Compensation of Trustees	$141,369.86
Office salaries	34,934.30
Office supplies and expenses	2,448.97
Petty cash	1,722.89
Office rent, net	3,419.10
Tax and financial services	498.75
Legal expenses	25,867.31
Miscellaneous	480.75
Total deductions disallowed	$210,741.93

(R. 8).

On the petitioners' petition to the Tax Court, the parties stipulated that, except for the item of $25,867.31 of legal expenses, the expenses originally disallowed were ordinary and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income (R. 11). Such items were therefore deductible under section 23(a)(2) of the Internal Revenue Code, which was added by section 121, Revenue Act of 1942, retroactively applicable to the year 1940.

The legal fees and expenses of $25,867.31 which remained in controversy were as follows:

(1) $16,439.96 was incurred in contesting a deficiency in income tax of the trust of $365,687.12, asserted for the year 1935. This was litigated in the Board of Tax Appeals (*William R. Kenan, Jr., et al.*, 40 B. T. A. 824 (1939)) and the Circuit Court of Appeals for the Second Circuit (*Kenan* v. *Commissioner*, 114 F. (2d) 217 (1940)). In this proceeding, the Courts sustained the Commissioner in holding that the trustees realized a gain from the sale or exchange of capital assets by exercising their power to pay partly in securities at market value the bequest of $5,000,000 payable to the testator's niece when she reached age 40 or as soon thereafter as compatible with the interests of the estate. The securities so delivered had appreciated in value since acquisition by the trustees and it was held that such delivery in satisfaction of this bequest, although within the discretionary powers of the trustees, was nevertheless a sale or exchange of the securities, giving rise to capital gain (R. 29).

(2) $780.85 was for services and disbursements in connection with the payment at the termination of the trust

of the above mentioned legacy to the University of North Carolina (R. 30).

(3) The remaining $8,646.50 of the total of $25,867.31 in legal fees and charges paid by the petitioners in 1940 was for services rendered in respect of the tax and other problems resulting from the expiration of the trust and the delivery of its assets to the legatees (R. 30).

The Commissioner conceded in his brief in the Tax Court that the trust property was held for the production of income, as those words are used in section 23(a)(2) of the Internal Revenue Code (R. 33) and there was no claim that the expenses were not ordinary and necessary (R. 33).

The Decisions Below.

The Tax Court, on the facts of this case, held in an opinion reviewed by the full Court that the legal expenses were deductible under section 23(a)(2) (R. 26). Two Judges dissented (R. 36). The Tax Court first refused to allow the expenses as expenses of carrying on a trade or business (R. 31). No appeal was taken from this part of the decision. The Tax Court then held that the $16,439.96 expense of the income tax litigation was deductible because it found that the effort of these trustees to relieve the estate from the payment of this tax was a factor in the management, conservation, and maintenance of the property of that estate, concededly held for the production of income (R. 33). Two Judges, who concurred in the result, did not adopt this ground for the decision (R. 35). The Tax Court then found that all the expenses (including the expense of the tax litigation) were incurred by the trustees in the performance of one of the principal functions of the management of such property while they were in complete

control of it, and that such expenses were deductible as expenses for the management of property held for the production of income (R. 33, 34).

The Circuit Court of Appeals reversed this decision (R. 45). The Court mentioned, but did not pass on, the Commissioner's contention that the expenses were in the nature of capital expenditures (R. 43). It based its decision on the ground that the expense of contesting the taxes "had no relation" to the management, conservation, or maintenance of property held for the production of income because the contest was not to produce income and did not affect the yield of investment capital or its appreciation (R. 43); it said that the expense of $780.85 for services in connection with the payment to the University of North Carolina "had no relation" to the production of income, or to the conservation of the property held for that purpose because it had to do with distribution and not with management (R. 44); it said that the remaining expenses of $8,646.50 were likewise paid in connection with distribution of trust assets and not with the production of income or the management of the property, were paid for services performed after the trust had ended, and that the advice "involved personal services rather than management of the trust estate" (R. 44).

The essential point of difference between the Tax Court and the Circuit Court of Appeals was that the former found that these expenses were directly connected with or related to the management of the property of this trust, whereas the latter found that such expenses bore "no relation" to such management.

Specification of Errors.

1. Under the principles established in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), the Circuit Court of Appeals

erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for management of income-producing property deductible under section 23(a)(2), on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a question of fact as to which the decision of the Tax Court should have been regarded as final.

2. Whatever view is taken as to the finality of the Tax Court's determination of fact, the Tax Court made no "clear-cut mistake of law" in holding that legal expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income-producing property to a beneficiary were expenses for the management of the trust property.

Summary of Argument.

The Tax Court in a carefully considered opinion, reviewed by the entire Court, held that the expenses here in controversy were expenses "for the management, conservation, or maintenance of property held for the production of income" deductible under section 23(a)(2). The Circuit Court of Appeals, without indicating any clear-cut mistake of law or referring to *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), reversed on the ground that such expenses had no relation to the production or collection of income or the management, conservation, or maintenance of property held for the production of income. The relationship of the expenses to the management of property held for the production of income was a question of fact. Under the principles as to appellate procedure established by this Court the factual determination of the Tax Court if

supported by substantial evidence, was not subject to review (*Dobson* v. *Commissioner*, 320 U. S. 489 (1943); *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119 (1944)).

The decision of the Tax Court involved no clear-cut mistake of law, was supported by substantial evidence, was in any case not without rational basis and was not contrary to any statute, any regulation having the force of law or any established legal principle.

The petitioners were the trustees of a large long-term trust holding property for the production of income. The expenses were ordinary and necessary. The nature of the expenses and their relationship to the management of the trust property were shown in detail. Everything the trustees did was pursuant to their duties in handling the property while subject to their complete control. The settling up by the trustees of this trust holding property for the production of income was an important and essential part of the management of such property.

The decision of the Tax Court does not contravene the provisions of section 23(a)(2) and the deduction allowed falls within its clear provisions. The statute allows not only the deduction of expenses "for the production or collection of income" but also of expenses "for the management, conservation, or maintenance of property held for the production of income." Congress intended to allow the deduction of all ordinary and necessary expenses incurred in the pursuit of income or in connection with property held for the production of income. The term "management" plainly includes the expenses of settling up a long-term trust holding property for the production of income, including the expense of litigating a claim that the delivery of property to a beneficiary pursuant to the terms of the will gave rise to taxable income.

The statute cannot properly be construed so as to narrow the deduction for expenses of management of property held for the production of income to the portion of such expenses incurred "for the production or collection of income." Where a long-term trust for the management of property held for the production of income is employed, a common practice, the management expenses involved in the necessary settling up of the trust are included in the allowable deductions.

The decision of the Tax Court does not contravene any regulation having the force of law. The regulations with respect to the deductibility of administration expenses of administrators and executors in handling an estate in process of administration are not applicable to the management expenses of trustees of a long-term trust. Administration expenses, which are primarily deductible in determining the gross estate subject to estate tax rather than net income subject to income tax, differ fundamentally from the expenses of managing a long-term trust of property held for the production of income. The trustees' management expenses here involved, including the expenses of settling up the trust, were not capital expenditures since they were not paid for the acquisition of any property and were not additions to cost of any property.

The decision of the Tax Court does not contravene any established legal principle. There is no established principle that expenses of income tax controversies of trustees not engaged in trade or business are not deductible under any facts or circumstances unless directly connected with the production or collection of income. In any particular case, such as this, where such expenses are ordinary and necessary expenses of management of property held for the production of income, they are deductible

under the clear provisions of section 23(a)(2) and of the Commissioner's regulation as to trustees' deductions. The question in each case is one of fact for final determination by the Tax Court.

ARGUMENT.

I.

The Circuit Court of Appeals erred in reversing the decision of the Tax Court that certain legal expenses of this trust were expenses for the management of income-producing property deductible under section 23(a) (2) on the ground that such expenses bore no relation to such management. The relation of such expenses to the management of the income-producing property was a question of fact as to which the decision of the Tax Court should have been regarded as final.

In this case the Tax Court, in a carefully considered opinion reviewed by the entire Court, found that the expenses in controversy were incurred by the trustees as an important part of their duties and functions in managing the trust property while they were in complete control of it, and that such expenses were "for the management * * * of property held for the production of income" and hence deductible under section 23(a) (2) of the Internal Revenue Code as added by section 121(a) of the Revenue Act of 1942 (R. 35).

The Circuit Court of Appeals reversed because it differed with the Tax Court as to the relationship of the expenditures to the management of the property held for the production of income. It took the view that the expenses

"had nothing to do with the production of taxable gain or ordinary income" (R. 43) and "had no relation" to the production of income or the management of property held for the production of income (R. 43, 44).

The merits and detailed facts of the case are discussed in point II below. Irrespective of these, it is submitted that the reversal of the Tax Court's decision by the Circuit Court of Appeals was erroneous under the principles as to appellate power set forth in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943) and *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119 (1944). The power of appellate courts upon review of Tax Court decisions is a "power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require". (Section 1141(c)(1), Internal Revenue Code, 44 Stat. 110.)

The relationship of these expenses to the management of the property held by these trustees for the production of income is purely a question of fact, as to which the Tax Court's decision if supported by substantial evidence, is final.

Every case in which the deduction of expenses is claimed involves a question of fact as to whether such expenses are incurred "in carrying on any trade or business" if the claim is made under section 23(a) (1), or are incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income" if the claim is made under section 23(a)(2). The factual inference or conclusion of the Tax Court on the facts of particular cases as to whether or not the expenses are incurred for the purposes designated in the statute is obviously of little value as a precedent in other

cases and, under controlling decisions of this Court, is not subject to review.

In *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), the Court said (p. 502):

> "when the court cannot separate the elements of a decision so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand. • • • Where no statute or regulation controls, the Tax Court's selection of the course to follow is no more reviewable than any other question of fact."

In *Commissioner* v. *Heininger*, 320 U. S. 467, 475 (1943), the Court said, in a controversy as to the deduction of business expenses:

> "Whether an expenditure is directly related to a business and whether it is ordinary and necessary are doubtless pure questions of fact in most instances. Except where a question of law is unmistakably involved a decision of the Board of Tax Appeals on these issues, having taken into account the presumption supporting the Commissioner's ruling, should not be reversed by the federal appellate courts. Careful adherence to this principle will result in a more orderly and more uniform system of tax deductions in a field necessarily beset by innumerable complexities."

In that case the Court reversed the Board of Tax Appeals solely because it had proceeded on a mistaken conviction that denial of the deduction claimed was required as a matter of law.

In *McDonald* v. *Commissioner*, 323 U. S. 57 (1944), involving the deductibility of campaign expenses of a state judge seeking election, the Court affirmed a decision of the Tax Court denying the deduction. After discussing the

question of statutory construction involved, the Court said at pages 64-65:

> "Even if these conclusions, in the setting of federal income tax legislation, derived less easily than they do from the statutory provisions under scrutiny, we should not be inclined to displace the views of the Tax Court with our own. Of course the Tax Court cannot define the limits of its own authority. And in cases like *Commissioner* v. *Heininger*, 320 U. S. 467, where the Tax Court mistakenly felt itself bound by superior judicial authority, we must give corrective relief. But, as a system, tax legislation is not to be treated as though it were loose talk or presented isolated abstract questions of law casting upon the federal courts the task of independent construction. Tax language normally has an enclosed meaning or has legitimately acquired such by the authority of those specially skilled in its application. To speak of tax determinations made in the system of review specially designed for federal tax cases as technical is not to imply opprobrium.
>
> Having regard to the controversies which peculiarly call for this Court's adjudication and to the demands for their adequate disposition, as well as to the exigencies of litigation generally, relatively few appeals from Tax Court decisions can in any event come here. That court of necessity must be the main agency for nation-wide supervision of tax administration. Whatever the statutory or practical limitations upon the exercise of its authority, Congress has plainly designed that tribunal to serve, as it were, as the exchequer court of the country. Due regard for these considerations is the underlying rationale of *Dobson* v. *Commissioner*, 320 U. S. 489. We are therefore relieved from discussing the numerous cases in which the Tax Court or its predecessor, the Board of Tax Appeals, allowed or disallowed deductions and their bearing on the situation before

> us. To do so involves detailed analysis of the special circumstances of various 'businesses' and expenses incident to their 'carrying on'. We shall not enter this quagmire of particularities."

In the dissenting opinion in the same case, at page 66, it is said:

> "Were the expenses incurred in an effort to produce income? Were these expenses, or part of them, 'ordinary and necessary' in connection with that effort? These are in most instances pure questions of fact and in cases such as this are to be determined by the Tax Court."

In *Commissioner* v. *Wemyss*, No. 629, October Term 1944, decided March 5, 1945, the Court, after stating in detail how the Tax Court dealt with the problem of the liability for gift tax, where an ante-nuptial gift was made because upon remarriage the income from a pre-existing trust would no longer be received by the prospective wife but would pass to her son, said:

> "The Tax Court in effect found the transfer of the stock to Mrs. More was not made at arm's length in the ordinary course of business. It noted that the inducement was marriage, took account of the discrepancy between what she got and what she gave up, and also of the benefit that her marriage settlement brought to her son. These were considerations the Tax Court could justifiably heed, and heeding decide as it did. It's conclusion on the issue before it was no less to be respected than were the issues which we deemed it was entitled to decide as it did in *Dobson* v. *Commissioner*, 320 U. S. 489, *Commissioner* v. *Heininger*, 320 U. S. 467, *Commissioner* v. *Scottish American Co.*, 323 U. S. 119."

See also *Commissioner* v. *Court Holding Company*, No. 581, October Term 1944, decided March 12, 1945.

Since the factual decision of the Tax Court—that the expenses in this case were sufficiently related to the management of property held for the production of income to be deductible—would be of little value as a precedent in other cases involving different facts, the case is of the type referred to in *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119, 125 (1944).

> "Moreover, this case exemplifies one type of factual dispute where judicial abstinence should be pronounced. The decision as to the facts in this case, like analogous ones that preceded it, is of little value as precedent. The factual pattern is too decisive and too varied from case to case to warrant a great expenditure of appellate court energy on unraveling conflicting factual inferences."

Under these principles, the decision of the Circuit Court of Appeals should be reversed because, without pointing out any clear-cut mistake of law or referring to the *Dobson* case, it reversed a decision of the Tax Court as to a purely factual question. The decision of the Circuit Court of Appeals is clearly contrary to the principles as to judicial review of Tax Court decisions established by this Court.

II.

Whatever view is taken as to the finality of the Tax Court's determination of fact, the Tax Court made no "clear-cut mistake of law" in holding that expenses of this trust incurred in winding up the trust and distributing its assets and in contesting the income tax effect of a transfer of income-producing property to a beneficiary were expenses for the management of the trust property.

Petitioners, of course, maintain, as they did before the Tax Court, that the expenses in question were clearly deductible under the statute.

We submit that in any case the decision of the Tax Court involved no "clear-cut mistake of law," was supported by substantial evidence, was not without rational basis and was not contrary to any statute, any regulation having the force of law or any established legal principle, and should therefore be affirmed.

The petitioners in this case were not individuals, but the trustees of a long-term testamentary trust. It was conceded by the Commissioner in the Tax Court that the trust property was "held for the production of income, as those words are used in section 23(a) (2)" (R. 33). The trust was obviously a large one, as it reported and paid income taxes of $312,629.27 for 1940 (R. 11), and the trustees received compensation in that year of $141,369.86, which the Commissioner stipulated was an expense for the management of property held for the production of income (R. 11, 12). The Tax Court states: "There is no dispute over whether the claimed deductions were ordinary and necessary expenses" (R. 33). The exact nature of the expenses

in controversy and their relationship to the handling of the trust property are shown in detail. It was not denied that everything the trustees did was pursuant to their powers and duties as trustees and that the expenditures were incurred while the property was under their complete control (R. 34). The Commissioner stipulated that all of the expenses originally disallowed, except the legal expenses, were within section 23(a)(2), making no attempt to allocate any part of the compensation of the trustees and their employees, the rent or other expenses, to the work done in settling up the trust pursuant to the provisions of the will.

On the basis of these facts the Tax Court approved the deduction as expenses of "management * * * of property held for the production of income" of the items here in question, as follows:

Deduction of the $16,439.96 of legal fees and charge paid in contesting a 1935 income tax deficiency of $365,687.12 was first approved on the following ground:

> "The effort of petitioners in seeking, through this litigation, to give such *relief to the estate*"—relief from payment of the deficiency in income tax—"was, in our opinion, obviously a factor in the conservation, management and maintenance of the property of the estate, concededly held for the production of income, since in resisting the imposition of the tax the trustees were performing the required duty of protecting and defending the trust property in their hands against any claim or lien for the tax" (R. 33). (Italics supplied.)

This same item of $16,439.96 and the additional expenses of $9,427.35 were approved as deductions by the Tax Court on the ground that they were all "expenses paid for the 'management' of the property" (R. 33).

The additional expenses involved problems arising out of the payment of the bequest to the University of North Carolina, the expiration of the trust and the distribution of its assets to the legatees (R. 30). The Tax Court said:

> "such payment and distribution were made by the trustees as directed by the will and as a part of their duties in managing the trust property" (R. 34).

The Tax Court further said that the expenses of "settling up" the trust estate were deductible

> "since one, if not the most, vital duty imposed on those trustees was to make proper distribution of such property, and in making it they were performing one of the principal functions of the management of such property, since until that property reached the hands of the legatees and distributees the trustees were in complete control of it, and thus its management" (R. 34).

The concurring Judges agreed that all the expenses in controversy were deductible on the ground that "the management of the property of the estate embraced the proper disposition of it pursuant to the will of the decedent" (R. 35).

We submit that there was substantial evidence to support the Tax Court's decision that, under the statute, such expenses were for the management of property held for the production of income and that under the facts of this case such decision was not unreasonable or without rational basis.

The decision of the Tax Court did not contravene the provisions of the statute.

Section 23(a)(2) has two branches. The section (1) allows the deduction of ordinary and necessary expenses "for the production or collection of income" and (2) the deduction of ordinary and necessary expenses for the "management, conservation, or maintenance of property held for the production of income." Both clauses must be given effect and the second clause cannot be narrowed to include only expenses "for the production or collection of income."

The Committee Reports show that what Congress intended was to allow the deduction of ordinary and necessary expenses incurred in connection with investment income and property, thus curing the inequity of the prior statute made manifest by the decision in *Higgins* v. *Commissioner*, 312 U. S. 212 (1941).

The House Report, set forth in full in the Appendix, page 31, says in part:

> "Thus whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable." (Appendix, p. 31)

The Report further says:

> "Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income." (Appendix, p. 32)

The Senate Report (Appendix, p. 34) is to the same effect.

The purpose of Congress clearly was to provide that as to investment income as well as to business income, the tax

would fall on "net income" and not on "gross income." The taxpayer was not required to prove that each expense had the direct purpose or result of producing income. The expense was deductible if incurred in connection with income-producing property and the broad words "management, conservation, or maintenance" were used. Such an expense was deductible even though there was no likelihood that gain or other income would actually be produced.

Although a statute allowing a deduction must be strictly construed (*New Colonial Ice Co., Inc.* v. *Helvering*, 292 U. S. 435 (1934); *Equitable Society* v. *Commissioner*, 321 U. S. 560, 564 (1944)), such a statute is not an exemption statute as the section here involved is characterized below (R. 44) and this Court has indicated that the rule means no more than that a statute allowing deductions covers only those items which "can conveniently come within" its "clear provision." (*McDonald* v. *Commissioner*, 323 U. S. 57, 60 (1944)).

The word "management" plainly includes the activities of the trustees of a long-term trust of property held for the production of income in settling up the trust and distributing its assets and in litigating an income tax controversy arising out of a distribution of income producing property held to give rise to taxable gain. "Management" is a word of comprehensive meaning and includes administration, care, carrying on, control, direction, etc. (38 C. J. 524). The word "manage" means "To control and direct; to handle successfully or cope with; to conduct; guide; administer" (Webster's New International Dictionary, Second Edition). "Management," as used in section 23(a)(2), is not confined in its meaning to "holding" or "operating." It necessarily includes a transfer of property by sale or exchange giving rise to capital gain,

such as the distribution to the testator's niece, which was held to be an exchange giving rise to gain. Similarly, the transfer of property upon the termination of the trust and the settlement of all the problems rising in connection therewith were an essential and important part of the management of the trust property.

The Circuit Court of Appeals, in so far as it purported to construe the statute, apparently took the view that expenses of "management" were deductible only if that particular phase of the handling of the property was designed to produce gain or income. Thus, the Court said with respect to the expense of the income tax litigation (R. 43):

> "It was not made as a recompense for management or maintenance of the trust property since that property was not held for the production of income but was in the hands of the trustees ready for distribution. Taxes laid upon it had nothing to do with the production of taxable gain or ordinary income. The expense of contesting the taxes had no relation to the 'management, conservation or maintenance of property held for the production of income.' The contest was not in order to produce income and the expenditure, accordingly, has no bearing upon such a purpose. To be deductible as expenses for management they must relate to the production of income or to the maintenance of property held for that purpose. They were not deductible when incurred merely to prevent the incidence of taxes which neither affected the yield of invested capital nor its appreciation."

This view that management expenses are deductible only if they are expenses incurred "for the production of income" is not supported by the language of the statute and

gives no effect to the second clause allowing the deduction of expenses "for the management, conservation, or maintenance of property held for the production of income." The latter clause cannot properly be so limited in its application as to mean no more than does the first clause.

The establishment of a long-term trust is a common method employed for the management of income-producing property. In every such case expense is involved in connection with the winding up of the trust, the distribution of the trust properties and the accounting to the beneficiaries at the termination of the trust. The trustees and their employees, accountants and attorneys must devote time and attention to this most important function and activity. This is an essential part of the management of the trust, and where the trust consists of property held for the production of income these expenses are properly deductible from income. Taxpayers are not required by the statute to analyze management expenses to determine which part of such expenses were incurred "for the production of income." All ordinary and necessary expenses of management of income-producing property are deductible.

The decision of the Tax Court does not contravene any regulation having the effect of law.

The Commissioner, when section 23(a)(2) was enacted, issued a long and comprehensive regulation (section 19.23(a)-15, Regulations 103) which is set forth in the Appendix, p. 36. There was at that time in effect a long-standing regulation with reference to "capital expenditures" (section 19.24-2) which is also set forth in the Appendix, p. 43. In opposition to the granting of the petition for certiorari the respondent claimed that the Tax Court's decision was contrary to these regulations. The Circuit Court of Appeals in its opinion below did not adopt this ground for decision.

The difficulty with this contention is that the respondent is relying on regulations with respect to the expenses of *administrators and executors* in administering an estate, which are primarily deductible in computing the gross estate, subject to estate tax and generally not deductible for income tax purposes. The expenses here in question are not expenses of the administration of an estate, which are deductible in computing an estate tax. They are expenses of trustees managing property held for the production of income and are deductible only from income. Hence the regulations referred to are inapplicable. (*Estate of Frederic E. Baldwin*, 44 B. T. A. 900 (1941); *Estate of John B. Sharpe* v. *Commissioner*, C. C. A. 3rd, March 6, 1945, not yet officially reported.)

The respondent relies on the following portions of the regulations. Section 19.23(a)-15, the new regulation promulgated under section 23(a)(2), provides in part (Appendix, p. 40):

> "Expenditures incurred by an administrator or executor in securing the processes and orders of the court having jurisdiction over the probate of the estate, or in collecting the assets of the estate (other than income which, if and when realized, must be reported by the estate for income tax purposes), or in adjusting claims against the decedent, or in distributing the remaining assets to the beneficiaries, or in conserving the assets for ultimate distribution to the parties entitled thereto, are not deductible under this section."

Section 19.24-2 of Regulations 103, Appendix, p. 43, which was in effect when the new regulation was promulgated merely provided in part:

> "Expenses of the administration of an estate, such as court costs, attorneys' fees and executors' com-

missions, are chargeable against the corpus of the estate and are not allowable deductions."

Both the new and the old regulation relied on by the respondent have to do only with expenses of administration incurred by an *administrator or executor*, and have no application to the present controversy.

The new regulation under section 23(a)(2) contains an entirely separate provision as to the expenses of *trustees*, which reads as follows (Appendix, p. 41):

> "Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production or collection of trust income or with the management, conservation, or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a trade or business."

This regulation as to *trustees* follows substantially the language of the statute allowing broadly to trustees the deduction of expenses "in connection with the production or collection of trust income or with the management, conservation, or maintenance of trust property." This is the controlling regulation in the present case.

The expenditures here in controversy are not capital expenditures such as were involved in *Bowers* v. *Lumpkin*, 140 F. (2d) 927 (C. C. A. 4th, 1944), cert. den. 322 U. S. 755, and *Helvering* v. *Stormfeltz*, 142 F. (2) 982 (C. C. A. 8th, 1944). Capital expenditures are "Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate." (Section 24(a)(2), Internal Revenue Code.) Capital expenditures represent the cost of acquiring property or title and are added to the cost. No asset of this trust

was acquired nor was its cost to anyone increased by reason of the expenditures here in controversy. They were expenses of handling or managing the property pursuant to the plan set up in the testator's will.

The decision of the Tax Court was not contrary to any established legal principle.

Giving no effect to the express provisions of the statute, the respondent may contend that under no factual circumstances can expenses of contesting income tax matters be regarded as incurred for the management, conservation, or maintenance of property held for the production of income, and that such expenses are never deductible by taxpayers not engaged in trade or business except to the extent that the recovery of taxable interest is involved. This is the position which the Commissioner seems to have taken in one portion of section 19.23(a)-15 of Regulations 103 reading as follows:

> "Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income" (Appendix, p. 42).

If by this portion of the regulation the Commissioner means to rule that under no circumstances can trustees not engaged in business deduct expenses in connection with income tax returns and controversies except to the extent

that such expenses are incurred "for the production of income," the regulation is not in conformity with the statute and is inconsistent with the portion of the regulation quoted at page 26 above, which, as provided in the statute, permits trustees to deduct expenses incurred "for the management, conservation, or maintenance of trust property held for the production of income."

The Circuit Court of Appeals in its opinion below erroneously intimates that trustees can never deduct expenses of litigation over income taxes as expenses of management of the trust properties because they have to do with past transactions and do not affect the yield of investment capital or its appreciation (R. 44).

The cases cited by the Circuit Court of Appeals, in all of which the Tax Court or its predecessor was affirmed, establish no such rule of law. In *Stoddard* v. *Commissioner*, 141 F. (2d) 76 (C. C. A. 2nd, 1944), the decision simply was that an individual taxpayer could not deduct expenses of contesting prior years' income taxes where there was no proof of the nature of the controversy. (See 47 B. T. A. 584, 588). In *Higgins* v. *Commissioner*, 143 F. (2d) 654 (C. C. A. 1st, 1944), the Court refused to hold that the statute in all cases allowed as expenses of management the deduction of expenses in connection with individual income tax controversies, the Court's view being that the deductibility of such an item was a question of fact in each case. In *Hord* v. *Commissioner*, 143 F. (2d) 73 (C. C. A. 6th, 1944), the expenses disallowed were with respect to a controversy over an undescribed income tax refund for 1928 and the determination of an undescribed deficiency for 1929. In none of these cases did the proof submitted establish any connection between the expenses claimed and the management of property held for the production of income.

The Tax Court was, of course, familiar with these decisions. It has nevertheless in this and in other cases, on the submission of proper proof, allowed the deduction of expenses of income tax controversies, particularly where, as in this case, the controverted transaction was one which itself gave rise to taxable income. *Charles H. Manning*, 3 T. C. 853, 874 (No. 108) (1944). The Tax Court there said that if the "original transaction was proximately related to the production or collection of income, any litigation arising out of that transaction involving its tax consequences would also proximately relate to the production or collection of income." This view is confirmed in *Estate of Frederick Cecil Barthelomew*, 4 T. C. No. 44 (1944), and is supported by the reasoning in *Kornhauser* v. *United States*, 276 U. S. 145 (1928).

The question is not one of general policy, as such expenses are, of course, fully deductible by corporations and by individuals, partnerships or trusts carrying on or doing business. There is no reason of policy for denying such deductions to individuals or trusts having investment income if otherwise they fall within the terms of the statute.

The Tax Court has held that the legal expenses of these trustees, which are here in controversy, were, under the facts of this case, expenses for the management of property held for the production of income. Such expenses of management are deductible under the clear provisions of the statute and of the Commissioner's regulation as to deductible expenses of trustees.

Conclusion.

For the foregoing reasons it is respectfully submitted that the judgment of the Circuit Court of Appeals for the Second Circuit should be reversed and the decision of the Tax Court affirmed.

Respectfully submitted,

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Petitioners.

Appendix.

H. Rep. No. 2333, 77th Cong., 2nd Sess., pp. 46, 74-76:

6. Nontrade or Nonbusiness Deductions

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to the tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable.

Section 118. Nontrade or Nonbusiness Deductions.

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management,

conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses to be deductible under Section 23 (a)(2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction,

whether under section 23 (a) (2) or otherwise, which is allocable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Expenses incurred by an administrator or executor in the administration of the estate of a decedent, such, for example, as expenses in securing the processes and orders of the court having jurisdiction over the probate of an estate, or in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or an executor for the production or collection of income which must be reported by the estate for income tax purposes, may be claimed as deductions under this section notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax. Accordingly, subsection (c) of this section amends section 162 to provide that no deduction shall be allowed under section 23 (a) (2) in computing the net income of the estate for amounts for which there may have been or has already been allowed a deduction under section 812 (b) in computing the net estate of the decedent. The present amendment would not allow as a deduction under section 23 (a) (2) for income tax purposes any amount which is allowable under section 812 (b) as a deduction in computing the net estate of a decedent for estate tax purposes, unless the Commissioner receives a statement, filed within the time and in the manner and form prescribed by him, to the effect that the amount in question has not been claimed or allowed as a deduction under section 812 (b) and that the right to have such items allowed at any time as a deduction under section 812 (b) is waived.

Subsection (d) of this section amends section 23 (1) of the Internal Revenue Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Internal Revenue Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

S. Rep. No. 1631, 77th Cong., 2nd Sess., pp. 87-88:

SECTION 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

This section is the same as section 118 of the House bill, except that subsection (c) of that section has been omitted therefrom and now appears as section 163 and a clerical amendment has been made in subsection (b). The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and

limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or more classes of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Subsection (c) of this section amends section 23 (l) of the Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear, and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-15 (as inserted by T. D. 5196, 1942-2 Cum. Bull. 96, 97-100, and amended by T. D. 5280, 1943, Cum. Bull. 1022, and T. D. 5331, 1944-4, Int. Rev. Bull. 4). *Nontrade or Nonbusiness Expenses.—(a) In general.* Subject to the qualifications and limitations in Chapter 1 and particularly in section 24, as amended, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of in-

come or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24, as amended. Section 24 (a) (5), as amended, continues to disallow any amount otherwise allowable as a deduction (whether under section 23 (a) (2) or otherwise) which is allocable to one or more classes of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest.

Thus any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation or maintenance of property held for the production of such income is not deductible under section 23 (a) (2). Nor does section 23 (a) (2) allow any expenses which are disallowed by any of the provisions of Chapter 1 of the Code.

Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the produc-

tion or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

Among expenditures not allowable under section 23 (a) (2) are the following: Commuters' expenses; expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23 (a) (2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income;

and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment.

Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

Expenditures incurred by an administrator or executor in securing the processes and orders of the court having jurisdiction over the probate of the estate, or in collecting the assets of the estate (other than income which, if and when realized, must be reported by the estate for income tax purposes), or in adjusting claims against the decedent, or in distributing the remaining assets to the beneficiaries, or in conserving the assets for ultimate distribution to the parties entitled thereto, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or executor for the production or collection of income which, if and when realized, must be reported by the estate for income-tax purposes, such as fees for collecting rents on property in the estate of the decedent, or for collecting interest or dividends on securities in that estate, or which are paid or incurred during the taxable year for the management, conservation, or maintenance of property in the estate of the decedent held for the production of income, the income from which, if and when realized, must be reported by the estate for income tax purposes, such as expenditures for insurance or repairs, or expenditures of a similar nature, are deductible under this section at the option of the taxpayer notwithstanding that deductions there-

for are allowable under section 812 (b) in computing the gross estate subject to the estate tax, provided the requisite statement and waiver are filed. (See section 162 (e).)

The ordinary expenditures of administration incurred in a receivership or bankruptcy proceeding are not deductible. Such expenditures include expenditures incurred in the performance of the ordinary duties of a receiver or trustee in bankruptcy, as, for example, fees paid to the attorney for the petitioning creditors, fees paid to the appraisers, and disbursements which are made in connection with the proceeding and which look toward the collection of the assets and their preservation pending ultimate distribution to the parties entitled thereto.

Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production or collection of trust income or with the management, conservation, or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a trade or business.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property, held for the production of income, belonging to the ward or minor, are deductible.

It is immaterial whether the expenses of fiduciaries are paid from the corpus of the estate or from income. Expenses derive their character not from the fund from which they are paid, but from the purposes for which they are incurred.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7), added by section 130 (a) of the Revenue Act of 1942.) Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code can not again be deducted under any other provision thereof.

SEC. 19.24-2 (as amended by T. D. 5166, 1942-2 Cum. Bull. 87). *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (l).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. (See section 19.22 (a)-17.) An assessment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provi-

sions of the Internal Revenue Code, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are capital expenditures and not deductible from gross income. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary.

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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 932.

Trust u/w of MARY LILY (FLAGLER) BINGHAM, Messrs. WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, Trustees,

Petitioners,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR PETITIONERS.

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Petitioners.

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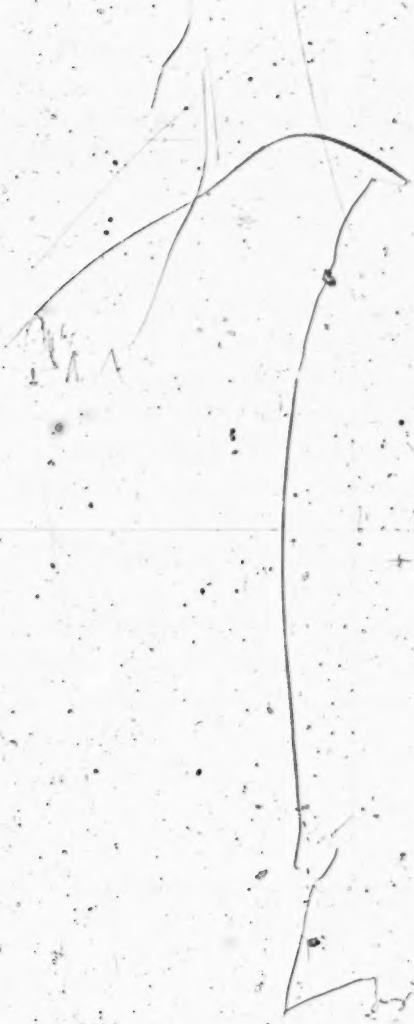

Supreme Court of the United States

OCTOBER TERM, 1944

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TRUST U/W of MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., and LAWRENCE C. HAINES, Trustees,

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against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR PETITIONERS.

On analysis, the brief for the Respondent, the Commissioner of Internal Revenue, does not meet the proposition in Petitioner's main brief and in the petition for the writ that brought the case before this Court—that the Court below in reversing the decision of the Tax Court failed to apply the principle of *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), to which that Court made no reference and failed to show that the Tax Court had proceeded on the basis of some clear-cut mistake of law. Specifically, we submit the following:

I.

Respondent fails to show that the question presented here is one of law.

What the Tax Court decided was that the expenditures by the Trustees (the Petitioners) here in question were expenses incurred for the management of property held for the production of income, and were hence deductible from income under the provisions of Section 23(a)(2) of the Internal Revenue Code as amended by Section 121 of the Revenue Act of 1942. The Court below reversed this decision, not on the ground which Respondent now chiefly suggests that it conflicted with Regulations of the Commissioner, but on the ground that the expenditures in question did not relate to the management of the trust property. This question, on which the decision turns, we maintain is essentially a question of fact and that under the principle of the *Dobson* case the decision in the Tax Court was final.

Respondent in his brief does not controvert any proposition of law advanced by the Tax Court. He does not, of course, deny that the Tax Court properly proceeded on the basis that ordinary and necessary expenses incurred for the management of property held for the production of income are deductible, as the statute plainly provides. Instead Respondent urges that this Court should promulgate two propositions, stated to be of law.

The first of these is

> "(1) That legal fees and charges incurred in distributing the corpus of a testamentary trust estate to the legatees are not expenses incurred 'for the management, conservation, or maintenance of property held for the production of income' within the

meaning of Section 23(a)(2) of the Internal Revenue Code as amended." (R. br., p. 12)

Clearly, such a proposition, if a proposition of law at all, is inapplicable here. The distributees were not legatees. The legatees under the will were the Trustees, the Petitioners. The beneficiaries took under the trust, not directly under the will.

But the proposition, even were it stated in reference to the particular facts before the Court, is hardly one of law. The question involved is one as to the application of a general statute to a particular state of facts—a matter which, under the *Dobson* decision, is left to the Tax Court for final determination.

The defect in the first suggested proposition of law is still more evident in the second proposition which is

> "(2) that expenses incurred after and just prior to the scheduled expiration of the term of a trust, in litigating an alleged tax deficiency of the trust, growing out of a payment previously made to a legatee, are not such expenses; or, more broadly, that the expense of opposing any tax deficiency affecting neither the yield nor the appreciation of non-business capital retained by the taxpayer is not such an expense." (R. br., p. 12-13)

Here, very clearly the suggestion is that the decision as to the application of a statute, general in terms, to a particular state of facts should be couched as in itself a general proposition of law. It is suggested that this proposition and the first proposition, if established, would result in "carving out" these expenditures as non-deductible, as lobbying expenses were excluded as not being "ordinary and necessary" under the decision relied on by the Respondent. (*Textile Mills Corporation* v. *Commissioner*, 314

U. S. 326 (1941)). Here, however, no issue is presented as to a class of expenditures always considered as falling outside the classification of "ordinary and necessary expenses." In many connections legal expenses are deductible under the tax statutes.

If decisions as to the status under the statute of legitimate expenses in a particular case are to be couched as "propositions of law," it seems obvious that almost any decision of the Tax Court can still be reviewed by the Circuit Courts of Appeal, and, in many cases, brought before this Court. Such a result would be the very negation of the principle laid down by this Court in the *Dobson* decision, and since consistently followed. *Commissioner* v. *Heininger*, 320 U. S. 467 (1943); *McDonald* v. *Commissioner*, 323 U. S. 57 (1944); *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119 (1944); *Commissioner* v. *Wemyss*, No. 629, October Term, 1944, decided March 5, 1945; *Commissioner* v. *Court Holding Company*, No. 581, October Term, 1944, decided March 12, 1945.

It is to be noted that the Court of Appeals for the Second Circuit, from which this case comes, in a later decision seems to observe the *Dobson* opinion as it did not here (*Chenago Textile Corporation* v. *Commissioner*, 2nd C. C. A., March 25, 1945). The fact that in the latter case the decision of the Tax Court had been against the taxpayer, while the decision of the Tax Court in this case was in favor of the taxpayer is immaterial.

II.

The respondent fails to meet the proposition of our Petition and Brief that the decision of the Tax Court, reversed by the Circuit Court of Appeals, was based on "no clear-cut mistake of law" (Main brief, p. 18).

Respondent maintains, as if it were an original question, that the expenditures here under consideration are not deductible under the statute. With this proposition the petitioners of course entirely disagree, as stated in their brief and as they did before the Tax Court. Yet the proposition of the Respondent is not responsive to the burden resting on the Respondent under the principle of the *Dobson* decision. That principle requires Respondent to show that the decision of the Tax Court was based on a clear-cut mistake of law.

Ample justification for the decision of the Tax Court is set forth in our main brief (p. 18). We there show that in this case the function of the Trustees (the Petitioners) was solely that of management. The petitioners had no interest whatever in the trust property, its consumption or disposition, and were solely fiduciaries managing property held for the production of income. There is no possible question of personal, family or living expenses, of personal transactions or obligations, or of income from personal services or any source other than the trust property. It was conceded in the Tax Court that the trust property was "held for the production of income" within the meaning of the statute (R. 33) and the Tax Court so found. It cannot now be contended that the trust property which produced $477,772.02 of net taxable income in the year 1940 (R. 8) was not "held for the production of income" but was held for distribution (R. br. 25). It was

held for both purposes from the beginning to the end. The Tax Court's determination of this fact, based on respondent's concession and substantial evidence, is final. There was no dispute over whether the claimed deductions were ordinary and necessary expenses (R. 33).

The sole question before the Tax Court was whether these particular expenses were for management of the trust property. The Tax Court held that they were, as the duty of the Trustees was to manage the property from the moment when they received it until they ultimately disposed of it, in accordance with the terms of the trust. Until such disposition was made there was no moment at which the Trustees ceased to hold and manage the property in their hands as income-producing property. The grounds for holding on these facts that under the statute the Tax Court was justified in concluding that the expenses are deductible were set forth in our main brief (Main br., p. 18).

Respondent maintains, however, that the history of the statute (Section 121, Revenue Act of 1942) shows that subsection 2 of section 23(a), added by that statute (Main br., pp. 2-3) was not intended to cover such expenditures as are here in question. Respondent relies wholly on what is said in the Committee Reports in regard to *executors and administrators of estates.* Nothing whatever is said in the Reports in regard to the application of the statute to trusts. As a matter of fact, the Reports show that the language was intended to be clear and comprehensive (Main br., p. 21).

Respondent appears to rely largely on an argument that the Regulations of the Commissioner negative the deduction. Respondent suggests that all deference to the determinations of the administrative bodies below the Circuit Courts of Appeal should be paid to the Commissioner

rather than to the Tax Court. It seems to the Respondent wholly objectionable that any question should be left to determination under the statute on the facts, without a governing pronouncement by the Commissioner. Respondent seems to ignore the idea so clearly expressed in the statutes that between the determination of the Commissioner and the ultimate liability of the taxpayer there should be a review by an independent body, in this case for most questions the Tax Court, as this Court has held.

It is to be noted that the decision of the Circuit Court of Appeals below was not based on any application of the Regulations of the Commissioner, but instead upon the Court's own view as to whether the disputed expenses could be regarded as incurred for the management of income producing property. That is where the difference between that Court and the Tax Court came in.

In fact, no Regulation of the Commissioner expressly deals with the question. Petitioners maintain that the governing regulation is that part of section 19.23(a)-15, reading as follows:

> "Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production or collection of trust income or with the management, conservation, or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a trade or business" (Main br., Appendix, p. 41).

Respondent relies on three expressions in the Regulations. These are the portion of section 19.23(a)-15 with respect to expenses of administration incurred by an administrator or executor (Main br., Appendix, p. 40); the portion of section 19.24-2 also dealing with expenses of

administration of an estate under the heading "capital expenditures" (Main br., Appendix, p. 43), and the portion of section 19.23(a)-15 dealing with expenditures incurred in tax controversies (Main br., Appendix, p. 42).

The Regulation with regard to expenditures of executors and administrators of estates is plainly not applicable to trustees, as we have stated in our main brief (p. 25). Respondent suggests that the treatment of trustees should be made the same. We believe, as the Tax Court held (R. 34), that there is ample ground for difference, and that in any case, if such result were intended, it should be and would have been expressed in the Regulations rather than left to be developed by construction.

As to capital expenditures, we have pointed out that in no view could these expenditures be regarded as within that category, as the Trustees were neither acquiring property nor defending the title to property in making these expenditures (Main br., p. 26).

The Regulation as to the non-deductibility of expenses incurred for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income), if read alone, might seem to raise a question, as is pointed out in our main brief, page 27. But this portion of Section 19.23(a)-15 must be read in the light of the entire Regulation. If a particular expense is shown to be incurred for the management of income-producing property it is clearly deductible under the general provisions of the Regulation, even though incurred in connection with an income tax controversy. *Charles H. Manning*, 3 T. C. 853 (No. 108) (1944). Properly construed, the Regulation as to the deduction of expenses of tax controversies means only that such expenses are not deductible *as such*. The relationships of such expenses

to the production of income or the management of income producing property must be shown. If the Regulation means that expenses of tax controversies are not deductible, even though found to be expenses incurred for the management of property held for the production of income, the Regulation is not a construction of the statute, but an attempt to amend it. Clearly, it lay within the jurisdiction of the Tax Court to disregard such an attempt. It is, of course, to be borne in mind that the Regulation as to expenses of tax controversies has no bearing on the expenses here involved other than the expense of the income tax litigation.

It is striking that Respondent makes no contention as to the meaning of the word "management" used in the statute according to its common usage. He makes no claim that the activities of the Trustees here in question were not an ordinary, necessary and proper part of their duties in managing the trust property. His contentions seem to be directed not to the meaning of the statute but to the facts. He contends that the trust property was not "held" as a source of income (R. br. 20, 25), but that it was held for distribution, a question of fact decided against the Commissioner on his concession by the Tax Court; that the expenses should be treated as if they were expenses of administration of an estate (R. br. 21), which they clearly were not in fact; that the expenses bore no relation to the property as a source of income but had to do solely with its devolution (R. br. 22), a question of fact; that the expenses were capital expenditures (R. br. 23), a question of fact; that there was no proximate relationship between the litigation expenses and the property held for the production of income (R. br. 26), a question of fact; and that the Regulation as to expenses of tax controversies

bars the deduction of the tax litigation expenses because of a lack of the requisite proximate relation to the property (R. br. 27) although the Tax Court found as a fact that the necessary relationship of the expenses to the management of the trust property existed.

Respondent seems to place some reliance on decisions of the lower Courts in other cases. These, as we maintain in our main brief (p. 28), turned on the particular facts or failure of proof. We have no quarrel with Respondent's proposition:

> "Deduction of the expenses of contesting taxes, which have not been shown to have a proximate relation to the management, or preservation of property held for the production of income, or to income from the property, has not been allowed". (R. br., p. 28).

We accept that result, but point out that the fact here is that the Tax Court determined that the tax litigation expenses, like the other expenses in controversy, had "a proximate relation to the management or preservation of property held for the production of income." Respondent attempts in his brief to argue that that conclusion was incorrect as did the Court below. Our position remains that on the decision of that question of fact—on which the result in the case turns—the decision of the Tax Court was final.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 932

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., AND LAWRENCE C. HAINES, TRUSTEES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The majority (R. 36–49), concurring (R. 49), and dissenting (R. 49–53) opinions in the Tax Court are reported in 2 T. C. 853. The opinion of the Circuit Court of Appeals (R. 55–59) is reported in 145 F. 2d 568.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 27, 1944 (R. 59). The petition for a writ of certiorari was filed on Feb-

ruary 9, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether certain legal fees and expenses paid by trustees are deductible as "non-trade or non-business expenses" within the meaning of Section 23 (a) (2) of the Internal Revenue Code, as added by Section 121 of the Revenue Act of 1942.

STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes, regulations and committee reports involved are set out in the Appendix, *infra,* pp. 12–24.

STATEMENT

The Tax Court found the following facts (R. 36–41):

At all times since prior to January 1, 1940, the taxpayers were the duly qualified and acting trustees of a trust created by the will of Mary Lily (Flagler) Bingham. Their principal office was in New York, New York. They filed their income tax return for the taxable year with the Collector of Internal Revenue for the Second District of New York. Their books and accounts have always been kept on a cash basis and the income tax return filed by them for the taxable year, 1940, was filed on the same basis. (R. 36–37.)

Mary Lily (Flagler) Bingham died on July 27, 1917. By her will, which was dated September

23, 1916, and duly probated in August, 1917, she appointed two individuals as executors and trustees and, after making a certain devise of real estate and certain specific bequests of jewelry, provided for the conveyance to the trustees of all the residue of the property, real and personal, of which she should die seized and possessed. The will provided for the payment by the trustees to various parties of at least $536,000 in cash legacies and for the delivery by the trustees to various other parties of 40,250 shares of Standard Oil Company stock. All of these beneficiaries were to receive their legacies as soon as compatible with the due administration of the estate and the carrying out of the testator's wishes with reference to the hotel and railroad properties mentioned in item ninth of the will hereinafter set out. The will further provided for the payment of $200,000 annually to a niece of the testator until that niece attained the age of forty years, when she was to be paid the lump sum of $5,000,000, if compatible with the interest of the estate as determined by the trustees. The will also provided that the trustees should pay $75,000 annually to the University of North Carolina during the continuance of the trust and at the expira on thereof should pay to the university such a sum in cash as would produce an annual income of $75,000. (R. 37–38.)

Item ninth of the will provided as follows (R. 38–39):

All the rest and residue of my estate including all lapsed bequests or devises, shall be held for the term of twenty-one years from the date of this will by my said Trustees in trust for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties (which are hereinafter called "Principal properties") and the properties held by subsidiary Companies. And to that end, my said Trustees shall have power to sell any of my said residue estate, except the stocks and bonds of said "principal properties," to invest the proceeds of such sales and the income and increments of all my said residue estate in such securities or other properties as they may think best; to use any of the said proceeds or said income or increments for the benefit of any of said principal or subsidiary properties; to make and execute any and all obligations, and all pledges and mortgages of any of my said residue estate except the stocks and bonds of the said principal properties, which may be necessary for the purposes of the maintenance, administration or development of the said principal or subsidiary properties; to exchange any of said properties, other than the principal properties and the stocks and bonds thereof, for any property which to them may seem desirable to be acquired for the benefit of the said principal or subsidiary properties, and continuingly to invest, sell and reinvest at

such times and in such manner and in such sums and in such properties as may seem to them desirable for the purpose of carrying out the maintenance, administration and development of the said properties the primary purpose of this trust being the keeping together of the enterprise into which my beloved husband, Henry M. Flagler, put so much of his energy, ambition and life.

The will further provided that each of the trustees should receive compensation at the rate of $50,000 a year for services as trustee and such compensation also should cover all services which each trustee might render as executor (R. 39).

At the end of twenty-one years from the date of the will the trustees were to divide the property then in their hands into three equal parts and transfer such parts to the testator's two sisters and brother in equal shares (R. 39).

The Commissioner's determination of a deficiency resulted from the disallowance of $210,741.93 expenses paid by taxpayers in the taxable year and deducted by them from gross income in their income-tax return for that year. The Commissioner's reason for the disallowance of these expenses was that they were not ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of Section 23 (a) of the Internal Revenue Code. By stipulation the parties have agreed that all of the expenses originally disallowed by the Commissioner

were ordinary and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, save one item of $25,867.31 paid for legal fees and charges (R. 39–40). The expenses so agreed upon are as follows (R. 40):

Compensation of trustees	$141,369.86
Office salaries	34,934.30
Office supplies and expenses	2,448.97
Petty cash expenditures	1,722.89
Office rent (net)	3,419.10
Tax and financial services	498.75
Miscellaneous expenses	480.75
Total	184,874.62

Of the legal fees and charges of $25,867.31 paid by the taxpayers, $16,439.96 was incurred for services rendered from August, 1937, to January, 1940, in contesting a deficiency of $365,687.12 in income tax asserted against the taxpayers for the year 1935. This deficiency was asserted by reason of the inclusion by the Commissioner in income of alleged gains of $1,991,316.75 resulting from the partial payment in securities of a bequest to Louise Clisby Wise of $5,000,000 under the above-mentioned will. The payment was made in 1935 under the provision of the will that when Louise Clisby Wise reached the age of forty, or as soon thereafter as was compatible with the interests of the estate, she was to be paid the sum of $5,000,000. When Louise Clisby Wise became forty years of age, the trustees paid her $5,000,000 partly in cash and partly in securities.

Some of the securities had been purchased by the trustees and some had been received by the trustees as part of the estate of the decedent at her death, which latter securities had appreciated in value during the period held by the trustees. The Commissioner determined that, to the extent that the value of the securities purchased exceeded their cost and to the extent of the appreciation of the other securities, the distribution thereof resulted in capital gains taxable as specified in Section 117 of the Revenue Act of 1934. In the case of *Kenan* v. *Commissioner*, 40 B. T. A. 824, the Commissioner's determination was sustained, and in 114 F. 2d 217 (C. C. A. 2d), the decision was affirmed upon appeal. The legal fees here in dispute were paid for services rendered by attorneys in connection with the proceedings there involved. Payments to the attorneys also covered reimbursements for expenses incurred by them in contesting the deficiency. (R. 40–41.)

Of the legal fees and charges paid by the taxpayers, the amount of $780.85 was for services in connection with the payment of the above-mentioned legacy to the University of North Carolina and for stenographic expense incurred by the attorneys in connection with those services (R. 41).

The remaining $8,646.50 of the total of $25,867.31 in legal fees and charges paid by the tax-

payers in 1940 was for services rendered in respect of the tax and other problems resulting from the expiration of the trust and delivery of its assets to the legatees (R. 41).

The Tax Court allowed the disputed deduction (R. 47–49), but the Circuit Court of Appeals reversed (R. 59).

ARGUMENT

The Circuit Court of Appeals, reversing the decision of the Tax Court, held, correctly we submit, that the amount in controversy was not allowable as a deduction in computing the income tax of the trustees under Section 23 (a) (2) of the Internal Revenue Code, as amended (Appendix, *infra*, p. 12), either as "ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." In so holding, the court took the view (R. 57–58) that expenses which are incurred in connection with the distribution of property to legatees do not come within the scope of the statute. The Circuit Court of Appeals also stressed the point that some of the expenses in question were made to contest income taxes assessed against the trustees, and followed its own prior decision in *Stoddard* v. *Commissioner*, 141 F. 2d 76, holding that such payments were not deductible under Section 23 (a) (2). In that case,

the court pointed out (pp. 79–80) that to extend the language of the statute to make it possible for taxpayers to deduct the expense of litigation over the amount of their income taxes would be too great a stretch in the absence of anything to indicate that Congress intended to so encourage such litigation. Other courts have reached a similar conclusion. *Higgins* v. *Commissioner,* 143 F. 2d 654 (C. C. A. 1st); *Hord* v. *Commissioner,* 143 F. 2d 73 (C. C. A. 6th).

The decision of the Circuit Court of Appeals is in harmony with the Treasury Regulations (Treasury Regulations 103, Secs. 19.23 (a)–15, 19.24–2; Appendix, *infra,* pp. 12–17, which were drawn with the intention of preserving the distinction between ordinary and necessary expenses of collecting or producing income on the one hand and capital expenditures on the other hand. Expenditures incurred in distributing assets to beneficiaries have long been treated as capital expenditures under the regulations. Sec. 19.24–2, Treasury Regulations 103, Internal Revenue Code; Art. 24–2, Treasury Regulations 101, 1938 Act; Art. 24–2, Treasury Regulations 94, 1936 Act; Art. 24–2, Treasury Regulations 86, 1934 Act; Art. 282, Treasury Regulations 77, 1932 Act; Art. 282, Treasury Regulations 74, 1928 Act; Art. 292, Treasury Regulations 69, 1926 Act. And the courts have uniformly held that capital expenditures are not deductible under the statute.

Bowers v. *Lumpkin*, 140 F. 2d 927 (C. C. A. 4th), certiorari denied, 322 U. S. 755; *Helvering* v. *Stormfeltz*, 142 F. 2d 982 (C. C. A. 8th). The regulations also support the view that the expenses of contesting income taxes are not deductible in the circumstances of this case. See Sec. 19.23 (a)–15, Treasury Regulations 103.

In support of their application for certiorari, the taxpayers contend that under *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231, the Circuit Court of Appeals was without authority to review the decision of the Tax Court. But we do not understand that the authority of the court below is so limited. The Tax Court's decision is contrary to the Treasury Regulations. Whatever may be the ramifications of the *Dobson* rule, as exemplified in other cases, such as *Commissioner* v. *Heininger*, 320 U. S. 467; *McDonald* v. *Commissioner*, 323 U. S. 57; *Commissioner* v. *Scottish American Investment Co.*, 323 U. S. 119; and *Commissioner* v. *Smith*, decided February 26, 1945, No. 371, this Term, we do not understand that the circuit courts of appeals are precluded from giving effect to the regulations in determining the scope of this deduction statute which, of course, must be strictly construed (see *Equitable Society* v. *Commissioner*, 321 U. S. 560, 564). We submit that in circumstances such as those here presented, where there is no dispute as to the underlying facts and the question is whether they fit the pattern of the statute as interpreted by the

regulations, the Circuit Court of Appeals properly sustained the Commission's determination. Cf. *Helvering* v. *Stormfeltz*, 142 F. 2d 982, 985 (C. C. A. 8th). The taxpayers also urge (Br. 16–18) that the relevant committee reports show that the deduction should be allowed. But clearly this is not so. The Committee reports, H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74–76; S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87–88 (Appendix, *infra*, pp. 17–24), reflect views which are wholly consistent with the regulations. Thus the House report states (p. 75):

> Expenses incurred by an administrator or executor in the administration of the estate of a decedent * * * in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section.

CONCLUSION

The decision is correct; there is no conflict; the petition should be denied.

Respectfully submitted.

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MARCH 1945.

APPENDIX

Revenue Act of 1942, c. 619, 56 Stat. 798:

SEC. 121, NON-TRADE OR NON-BUSINESS DEDUCTIONS.

(a) *Deduction for Expenses.*—Section 23 (a) (relating to deduction for expenses) is amended to read as follows:

"(a) *Expenses.*—

* * * * *

"(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

* * * * *

(d) *Taxable Years to which Amendments Applicable.*—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938.

* * * * *

(26 U. S. C. (Supp. III) 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)–15 (as inserted by T. D. 5196, 1942–2 Cum. Bull. 96, 97–100, and amended by T. D. 5280, 1943 Cum. Bull. 1022, and T. D. 5331, 1944–4 Int. Rev. Bull. 4). *Nontrade or Nonbusiness Expenses.*—(a) *In general.*—Subject to the qualifications and limitations in Chapter 1 and particularly in section 24, as amended, an ex-

pense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * * Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. * * *

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. * * *.

Capital expenditures, * * * are not allowable as nontrade or nonbusiness expenses. * * *

* * * * * *

Expenditures incurred by an administrator or executor in securing the processes and orders of the court having jurisdiction over the probate of the estate, or in collecting the assets of the estate (other than income which, if and when realized, must be reported by the estate for income tax purposes), or in adjusting claims against the decedent, or in distributing the remaining assets to the beneficiaries, or in conserving the assets for ultimate distribution to the parties entitled thereto, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or executor for the production or collection of income which, if and when realized, must be reported by the estate for income-tax purposes, such as fees for collecting rents on property in the estate of the decedent, or for collecting interest or dividends on securities in that estate, or which are paid or incurred during the taxable year for the management, conservation, or maintenance of property in the estate of the decedent held for the production of income, the income from which, if and when realized, must be reported by the estate for income tax purposes, such as ex-

penditures for insurance or repairs, or expenditures of a similar nature, are deductible under this section at the option of the taxpayer notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax, provided the requisite statement and waiver are filed. (See section 162 (c).)

* * * * *

Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production or collection of trust income or with the management, conservation, or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a trade or business.

* * * * *

It is immaterial whether the expenses of fiduciaries are paid from the corpus of the estate or from income. Expenses derive their character not from the fund from which they are paid, but from the purposes for which they are incurred.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered

in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7), added by section 130 (a) of the Revenue Act of 1942.) Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other section of the Internal Revenue Code

or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code can not again be deducted under any other provision thereof.

SEC. 19.24–2 (as amended by T. D. 5166, 1942–2 Cum. Bull. 87). *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (l).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. * * *

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74–76:

6. NONTRADE OR NONBUSINESS DEDUCTIONS

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to

the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayers' trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable.

SECTION 118. NONTRADE OR NONBUSINESS DEDUCTIONS

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property

held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no liklihood that the property will be sold at a profit or will otherwise be productive of income. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is sub-

ject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Expenses incurred by an administrator or executor in the administration of the estate of a decedent, such, for example, as expenses in securing the processes and orders of the court having jurisdiction over the probate of an estate, or in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or an executor for the production or collection of income which must be reported by the estate for income tax purposes, may be claimed as deductions under this section notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax. Accordingly, subsection (c) of this section amends section 162 to provide that no deduction shall be allowed under section 23 (a) (2) in computing the net

income of the estate for amounts for which there may have been or has already been allowed a deduction under section 812 (b) in computing the net estate of the decedent. The present amendment would not allow as a deduction under section 23 (a) (2) for income tax purposes any amount which is allowable under section 812 (b) as a deduction in computing the net estate of a decedent for estate tax purposes, unless the Commissioner receives a statement, filed within the time and in the manner and form prescribed by him, to the effect that the amount in question has not been claimed or allowed as a deduction under section 812 (b) and that the right to have such items allowed at any time as a deduction under section 812 (b) is waived.

Subsection (d) of this section amends section 23 (l) of the Internal Revenue Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Internal Revenue Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87–88:

SECTION 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

This section is the same as section 118 of the House bill, except that subsection (c) of that section has been omitted therefrom and now appears as section 163 and a clerical amendment has been made in subsection (b). The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable

year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or

more classes of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Subsection (c) of this section amends section 23 (l) of the Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear, and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 932

TRUST U/W OF MARY LILY (FLAGLER) BINGHAM, MESSRS. WILLIAM R. KENAN, JR., AND LAWRENCE C. HAINES, TRUSTEES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The majority (R. 30), concurring (R. 35), and dissenting (R. 36) opinions in the Tax Court are reported at 2 T. C. 853. The opinion of the Circuit Court of Appeals (R. 41–45) is reported at 145 F. 2d 568.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 27, 1944. (R. 45.) The petition for a writ of certiorari was filed on February 9, 1945, and was granted March 12,

1945. (R. 47.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether judicial review of the Tax Court's determination of the issues upon the merits is precluded by the principles stated in *Dobson* v. *Commissioner*.

2. Whether legal fees and charges incurred (a) in connection with the final distribution of a testamentary trust estate and (b) in litigating an income tax deficiency assessed by the Commissioner, growing out of the prior payment of a bequest by the trustees, are deductible as "non-trade or non-business expenses" within the meaning of Section 23 (a) (2) of the Internal Revenue Code.

STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes, regulations, and committee reports involved are set out in the Appendix, *infra*, pp. 30–42.

STATEMENT

The Tax Court found the following facts (R. 26–30):

At all relevant times the taxpayers were the trustees of a trust created by the will of Mary Lily (Flagler) Bingham. Their principal office was in New York, New York, and they filed their income tax return for the taxable year 1940 with

the Collector of Internal Revenue for the Second District of New York. Their books and accounts have always been kept on a cash basis and the income tax return filed by them for the taxable year was filed on the same basis. (R. 26.)

Mary Lily (Flagler) Bingham died on July 27, 1917. By her will, which was dated September 23, 1916, and probated in August, 1917, she appointed two individuals as executors and trustees and, after making a certain devise of real estate and certain specific bequests of jewelry, provided for the conveyance to the trustees of all the residue of the property, real and personal, of which she should die seized and possessed. The will provided for the payment by the trustees to various parties of at least $536,000 in cash legacies and for the delivery by the trustees to various other parties of 40,250 shares of Standard Oil Company stock. All of these beneficiaries were to receive their legacies as soon as compatible with the due administration of the estate and the carrying out of the testator's wishes with reference to the hotel and railroad properties mentioned in item ninth of the will hereinafter set out. The will further provided for the payment of $200,000 annually to a niece of the testator, Louise Clisby Wise, until she should attain the age of forty years, when she was to be paid the lump sum of $5,000,000, if compatible with the interest of the estate as determined by the trustees. The will

also provided that the trustees should pay $75,000 annually to the University of North Carolina during the continuance of the trust and at the expiration thereof should pay to the University such a sum in cash as would produce an annual income of $75,000. (R. 26–27.)

Item ninth of the will provided as follows (R. 19–20):

> All the rest and residue of my estate including all lapsed bequests or devises, shall be held for the term of twenty-one years from the date of this will by my said Trustees in trust for the maintenance and administration and development of the Florida East Coast Railway and the Florida East Coast Hotel properties (which are hereinafter called "Principal properties") and the properties held by subsidiary Companies. And to that end, my said Trustees shall have power to sell any of my said residue estate, except the stocks and bonds of said "principal properties," to invest the proceeds of such sales and the income and increments of all my said residue estate in such securities or other properties as they may think best; to use any of the said proceeds or said income or increments for the benefit of any of said principal or subsidiary properties; to make and execute any and all obligations, and all pledges and mortgages of any of my said residue estate except the stocks and bonds of the said principal properties, which may be necessary for the purposes of the maintenance,

> administration or development of the said principal or subsidiary properties; to exchange any of said properties, other than the principal properties and the stocks and bonds thereof. for any property which to them may seem desirable to be acquired for the benefit of the said principal or subsidiary properties, and continuingly to invest, sell and reinvest at such times and in such manner and in such sums and in such properties as may seem to them desirable for the purpose of carrying out the maintenance, administration and development of the said properties the primary purpose of this trust being the keeping together of the enterprise into which my beloved husband, Henry M. Flagler, put so much of his energy, ambition and life.

The will further provided that each of the trustees should receive compensation at the rate of $50,000 a year for his services, which should also cover the services which he might render as executor. (R. 28.)

At the end of twenty-one years from the date of the will the trustees were to divide the property into three equal parts for transfer to the testator's two sisters and brother in equal shares. (R. 28.)

The Commissioner's determination of a deficiency resulted from the disallowance of $210,741.93 expenses paid by the trustees in 1940 and deducted by them from gross income in their income-tax return for that year. The Commis-

sioner's reason for the disallowance of these expenses was that they were not ordinary and necessary expenses incurred in carrying on a trade or business within the meaning of Section 23 (a) of the Internal Revenue Code, now Section 23 (a) (1). By stipulation (R. 10–14) the parties agreed that all of the expenses originally disallowed by the Commissioner were ordinary and necessary expenses paid during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, save one item of $25,867.31 paid for legal fees and charges. (R. 28–29.) The expenses so agreed upon are as follows (R. 29):

Compensation of trustees	$141,389.86
Office salaries	34,934.30
Office supplies and expenses	2,448.97
Petty cash expenditures	1,722.89
Office rent (net)	3,419.10
Tax and financial services	498.75
Miscellaneous expenses	480.75
Total	184,874.62

Of the legal fees and charges of $25,867.31 paid by the taxpayers, $16,439.96 were for services rendered from August, 1937, to January, 1940, in contesting a deficiency of $365,687.12 in income tax asserted against the taxpayers for the year 1935. This deficiency was asserted by reason of the inclusion by the Commissioner in income of alleged gains of $1,991,316.75 resulting from the partial payment in securities of the bequest of

$5,000,000 to Louise Clisby Wise, above-mentioned. The payment was made in 1935, partly in cash and partly in securities at their then-current values. Some of the securities had been purchased by the trustees and some had been part of the estate of the decedent at her death. The Commissioner determined that, to the extent that the value of the securities purchased exceeded their cost and to the extent of the appreciation of the other securities, their distribution resulted in capital gains taxable as specified in Section 117 of the Revenue Act of 1934. It the case of *Kenan* v. *Commissioner*, 40 B. T. A. 824, the Commissioner's determination was sustained, and in 114 F. 2d 217 (C. C. A. 2d) the decision was affirmed upon appeal. (R. 29–30.)

Of the remaining legal fees and charges paid by the taxpayers, $780.85 were incurred in connection with the payment of the legacy to the University of North Carolina, described *supra*, p. 5. (R. 30.) The other $8,646.50 were paid for services rendered in respect of tax and other problems resulting from the expiration of the trust and the delivery of its assets to the legatees. (R. 30.)

The Tax Court allowed the disputed deduction (R. 35), but the Circuit Court of Appeals reversed. (R. 45.)

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SUMMARY OF ARGUMENT

I

The issues presented in this case are issues of law and not of fact. They relate to the correctness of certain general propositions which are asserted under the statute and upon which both Congressional committee reports and the Bureau of Internal Revenue in Treasury Regulations have taken positions. The court below was empowered to consider these issues upon the merits and was not bound by the Tax Court's determinations with regard to them.

If the petitioners' contention were upheld, the question of what constitute expenses incurred for the management of property held for the production of income would be left for determination in each case, without guidance other than that contained in the language of the statute itself. This is not a method of applying the statute which is administratively feasible or which was intended by Congress, as the committee reports demonstrate. Applicable Treasury Regulations cover the case, moreover; and their validity is in question. It has never been held that the Tax Court's decision of a question which involves the validity of a Treasury Regulation is one of fact. To the extent that deference is due from courts to administrative authority in determining such a question, it is owed to the Regulations and not to a decision of the Tax Court which conflicts with the

Regulations. This Court has so held in the past and it expressed the same view in *Dobson* v. *Commissioner*, 320 U. S. 489, 502. The Circuit Court of Appeals did not exceed its authority or violate the principles of the *Dobson* decision by reversing the decision of the Tax Court.

II

It was conceded in the Tax Court that the expenses here involved had no connection with the "production or collection of income" within the meaning of the statute. The question is whether these expenses were incurred for "the management, conservation, or maintenance of property held for the production of income." The rationale of Section 121 of the Revenue Act of 1942 (Appendix, *infra*, p. 30), adding the quoted words to Section 23 (a) of the Internal Revenue Code, is consistent. On the one hand the management or conduct and maintenance of income-producing property, enterprises, and activity give rise to expenditures which, with exceptions, are deductible; on the other hand, the expenses incident to consumption or other personal activity or to the transfer and devolution of property are not deductible, except as specific provision is made to the contrary.

The fees and charges connected with the final distribution of the trust estate bore no relation to the property as a source of income but had to do solely with its devolution. Their deduction would

go counter both to the words and to the rationale of the statute. The House committee report and the Treasury Regulation (Appendix, *infra,* pp. 32, 38) specifically deny the deduction of such expenses with respect to decedents' estates, and there is no adequate reason for a different conclusion with regard to trust estates.

The fees and charges incurred in contesting the income tax deficiency growing out of the payment to Louise Clisby Wise were paid to protect the trust property from liability for a tax upon the capital gain in shares of stock which had been transferred in paying the bequest to her. At the time the expenses were incurred the remaining property was ready for distribution. Consequently, as the court below found, the property was no longer being held for the production of income; and for this reason alone these expenses are not deductible. Even if the trust property be regarded as held for the production of income during the period the tax deficiency was contested, however, the expenses of the contest are not deductible. There must be a proximate relation between expenses and property in order to render the expenses deductible, as the Congressional committee reports and the Treasury Regulations all state (Appendix, *infra,* pp. 31, 37, 41).

The principle advanced by the court below, that the contested tax must affect the yield or the appreciation of the property, is more liberal than the

provision of the Regulation; but the court's principle excludes deduction of the expense of opposing the deficiency assessment in the present case. The property which appreciated in value and thereby gave rise to the tax liability asserted by the Commissioner had left the trustees' hands before the deficiency was assessed, and there was no relevant connection between it and the property which remained. In no permissible sense could the petitioners be said to be managing, conserving, or maintaining the remaining property by opposing the assessment of taxes upon past gains from other property. The lower-court decisions have on the whole been in accord with this view.

ARGUMENT

I

THIS CASE PRESENTS ISSUES OF LAW WHICH ARE SUBJECT TO REEXAMINATION UPON JUDICIAL REVIEW UNDER THE PRINCIPLES OF THE DOBSON DECISION

The petitioners err, we believe, in contending that the case involves issues of fact upon which the Tax Court's determination is final. Whatever may be the ultimate criteria for distinguishing questions of law from questions of fact for purposes of the judicial review of administrative decisions, including decisions of the Tax Court, cf. *Dobson* v. *Commissioner*, 320 U. S. 489, 501; Dickinson, *Administrative Justice and the Supremacy of Law* (1927), pp. 49–55, 312–318;

Stern, *Review of Findings of Administrators, Judges and Juries* (1944), 58 Harv. L. Rev. 70, 93–95, it is evident that issues of law and not issues of fact are presented in this case. These issues are broader than the particular facts presented. They relate to the correctness of certain general propositions which are asserted under the statute and upon which both Congressional committee reports and the Bureau of Internal Revenue in Treasury Regulations have taken positions. The court below was empowered to consider these issues upon the merits, subject to such deference as should be accorded to the legislative history and to applicable administrative determinations; and the issues are now before this Court for final decision.

The propositions advanced by the Commissioner, the validity of which is here involved, may be stated as follows: (1) That legal fees and charges incurred in distributing the corpus of a testamentary trust estate to the legatees are not expenses incurred "for the management, conservation, or maintenance of property held for the production of income" within the meaning of Section 23(a)(2) of the Internal Revenue Code as amended (Appendix, *infra*, p. 30); and (2) that expenses incurred after and just prior to the scheduled expiration of the term of a trust, in litigating an alleged tax deficiency of the trust

growing out of a payment previously made to a legatee, are not such expenses; or, more broadly, that the expense of opposing any tax deficiency affecting neither the yield nor the appreciation of non-business capital retained by the taxpayer is not such an expense. These are recurring issues in respect to the tax liability of trusts. If the issues are determined favorably to the Government, the result will be the "carving out [of] this special group of expenses * * * making them nondeductible" in future cases as well as in this case (*Textile Mills Corp.* v. *Commissioner,* 314 U. S. 326, 338); if they are determined favorably to the taxpayer, the same "special group of expenses" will have been rendered deductible. The question is, which result squares with the statute.

If the petitioners' contention were upheld in the terms in which it is made, the question of what constitute expenses incurred for the management of property held for the production of income would be left for determination in each case, without guidance other than that contained in the language of Section 23 (a) (2) of the Internal Revenue Code itself. This Court has not so held; nor is this a method of applying the statute which commends itself as administratively feasible or which was intended by Congress. The committee reports which accompanied the enactment of the statute (Appendix, *infra,* pp. 35–42) contain sub-

stantial guides to the meaning of the section in numerous of its applications—guides which, so far as they are given effect, constitute subsidiary propositions of law. As elaborated in the applicable Regulation (Treasury Regulations 103, Sec. 19.23 (a)-15, Appendix, *infra*, pp. 30–35), these guides, unless *ultra vires*[1] or legally erroneous, are controlling. *Textile Mills Corp.* v. *Commissioner, supra*, p. 337. Thus the matter is not left entirely at large, as this Court recognized in *McDonald* v. *Commissioner*, 323 U. S. 57.

It is true, of course, as this Court has stated (*Commissioner* v. *Heininger*, 320 U. S. 467, 475), that "in most instances" the relation of an expenditure to a business or, no doubt, to the management or preservation of property held for the production of income presents a question of fact, and that it is ordinarily a fact question whether a given expenditure is ordinary and necessary. It is also true, however, that such a question may become one of law because a controlling general proposition is involved. The passage from *Mc-*

[1] It would be late in the day to contend that the Treasury Department does not have authority to promulgate regulations under the revenue acts, after this Court for decades has held such regulations to be of the highest significance in determining the meaning of these acts. *Helvering* v. *Griffiths*, 318 U. S. 371, 395–397. Cf. Surrey, *The Scope and Effect of Treasury Regulations* (1940), 88 U. Pa. L. Rev. 556; Paul, *Use and Abuse of Tax Regulations in Statutory Construction* (1940), 49 Yale L. J. 660; Internal Revenue Code, Secs. 62, 3791 (26 U. S. C. Secs. 62, 3791).

Donald v. *Commissioner, supra,* which petitioners quote in their brief (pp. 15–16), holds that even then weight may attach to the determination of the Tax Court, as of course it may and as the *Dobson* opinion also stated (320 U. S. 489, 502)—not that the issue in that case was one of fact.

In the present case both the House committee report accompanying the Revenue Act of 1942, which added paragraph (2) to Section 23 (a) of the Internal Revenue Code, and the applicable Treasury Regulation (Appendix, *infra,* at pp. 38, 32) state explicitly that the expenses of administering a decedent's estate are not deductible under the new provision. The Regulation states also that expenditures incurred for resisting a proposed additional assessment of taxes, other than taxes on property held for the production of income, are not deductible. (*Infra,* p. 34.) Unless a testamentary trust is to be treated differently from a decedent's estate for this purpose, the first of these propositions applies to that portion of the claimed deductions having to do with distributions; and the second proposition applies to the remainder. Barring relevant legal considerations which require a contrary conclusion, the case is thus determined.

It is self-evident that the question whether a statutory provision shall be interpreted in ac-

cordance with a statement in its legislative history is one of law. Cf. Stern, *op. cit. supra*, p. 107. The same is true of the question of the validity of a Treasury Regulation; and in no case has it been held that the Tax Court's decision of such a question is one of fact.[2] The intention of Congress to provide for judicial review of questions involving Treasury Regulations, upon review of Tax Court decisions, seems clear from the legislative history of the present provision for such review. This provision was first enacted as Section 1003 (b) of the Revenue Act of 1926 (reenacted as Section 1141 (c) (1) of the Internal Revenue Code). It provides as follows: "Upon such review, such courts shall have power to affirm or; if the decision of the Board [Court]

[2] The recent decisions of this Court which petitioners cite upon the present point (Br. 16–17) simply illustrate the situations in which determinations of fact, rather than of law, are involved. In *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119, the Treasury Regulation bearing upon the issue in the case stated that the question "whether a foreign corporation has an 'office or place of business' within the United States depends upon the facts in a particular case", except that there must be "a place for the regular transaction of business" and not merely one where "casual or incidental transactions might be, or are, effected". This Court pointed out that there was "no charge here that the Tax Court failed to follow the applicable statute *or regulations*". [Italics supplied.] 323 U. S. at p. 123. *Fondren* v. *Commissioner*, No. 88, this Term, decided January 29, 1945, is illustrative of cases in which, although the question presented turns upon combinations of fact, an issue of law is involved. The Tax Court was affirmed, but the basis of its decision was thoroughly reexamined.

is not in accordance with law, to modify or to reverse the decision of the Board [Court], with or without remanding the case for a rehearing, as justice may require." The committee reports covering this section state that the reviewing courts "may consider, for example, questions as to * * * the proper interpretation and application of the statute or any regulation having the force of law * * *" (H. Rep. No. 1, 69th Cong., 1st sess., pp. 19–20 (1939–1 Cum. Bull. (Part 2) 315, 328); S. Rep. No. 52, 69th Cong., 1st sess., p. 36 (1939–1 Cum. Bull. (Part 2) 332, 359)).

To the extent that deference is due from courts to administrative authority in determining issues which are covered by Treasury Regulations, moreover, it is owed to the regulations and not to decisions of the Tax Court which conflict with them; for the Treasury in issuing regulations exercises the discretion and expertise which the revenue acts bring into play. This Court has held accordingly in the past—see, e. g., *Spreckels* v. *Commissioner,* 315 U. S. 626—and clearly expressed the same view in the *Dobson* case, in which the opinion specifically limits the principles there announced to situations in which "no statute or regulation" controls. 320 U. S. at 502; cf. also pp. 492, 506; *Welch* v. *Helvering,* 290 U. S. 111, 115; *Higgins* v. *Commissioner,* 143 F. 2d 654 (C. C. A. 1).

It has been the implicit assumption or the explicit assertion of the lower Federal courts in a number of cases that they may under some circumstances review the decisions of the Tax Court with regard to the validity of attempted expense deductions under Section 23 (a) (2) of the Internal Revenue Code, since *Dobson* v. *Commissioner* as before. *Helvering* v. *Stormfeltz*, 142 F. 2d 982 (C. C. A. 8) (Tax Court reversed); *Higgins* v. *Commissioner*, 143 F. 2d 654 (C. C. A. 1) (Tax Court affirmed); *Hord* v. *Commissioner*, 143 F. 2d 73 (C. C. A. 6) (Tax Court affirmed); *Stoddard* v. *Commissioner*, 141 F. 2d 76 (C. C. A. 2) (Tax Court affirmed).[3] See also *Bowers* v. *Lumpkin*, 140 F. 2d 927 (C. C. A. 4), certiorari denied, 322 U. S. 755). As in those cases, the issues in this case are reviewable, and the court below did not exceed its authority or violate the principles of the *Dobson* decision by reversing the decision of the Tax Court.

II

NEITHER THE LEGAL FEES AND CHARGES INCURRED IN DISTRIBUTING THE TRUST ESTATE NOR THOSE INVOLVED IN CONTESTING THE TAX DEFICIENCY WHICH RESULTED FROM THE PRIOR PAYMENT OF A LEGACY ARE DEDUCTIBLE UNDER SECTION 23 (a) (2) OF THE INTERNAL REVENUE CODE

Section 23 (a) (2) of the Internal Revenue Code as amended (Appendix, *infra*, p. 30),

[3] To the extent that *Heller* v. *Commissioner* (C. C. A. 9), decided January 27, 1945, 1945 C. C. H., vol. 4, par. 9169, may be considered at variance with these views, we submit that it was not correctly decided.

provides for the deduction of ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income. In the Tax Court proceedings the taxpayers conceded that the expenses involved had no connection with the "production or collection of income" as those words are used in the statute; and the question was narrowed to whether the expenses were paid "for the management, conservation, or maintenance of property held for the production of income." (R. 33.) The Tax Court held, two Judges dissenting, that all of the expenses in question are deductible as management expenses.

As to the expenses incurred in distributing the estate to the University of North Carolina and the residuary legatees, the Circuit Court of Appeals held that, since the distribution did not relate to the management of the property or to its conservation or maintenance, the expenses are not deductible. (R. 44.) As to the expense of contesting the tax deficiency growing out of the payment to Louise Clisby Wise, the court concluded that, since at the time of the proceedings the remaining trust property was not held for the production of income but was ready for distribution to the beneficiaries, and since the incidence of the contested tax "neither affected the yield of investment cap-

ital nor its appreciation", the "expense of contesting the taxes had no relation to the 'management, conservation or maintenance of property held for the production of income'." (R. 43–44.) We submit that the appellate court was correct on both points.

(a) *The Fees and Charges Connected with Distribution of the Estate.*

It is clearly the rationale of Section 121 of the Revenue Act of 1942 (Appendix, *infra*, p. 30), adding paragraph (2) to Section 23 (a) of the Internal Revenue Code, that the expenses which are rendered deductible by its second provision are those incident to the management, conservation, or maintenance of property which is being "held"—i. e., retained, although not necessarily without sale and reinvestment—as a source of income. Neither personal expenses on the one hand nor the expenses of distributing property to beneficiaries of the owner's or former owner's bounty on the other hand are rendered deductible by the statute.

This is made clear in the first paragraph of the House committee report accompanying the Act which deals with Section 121 (Appendix, *infra*, p. 36), in which it is said that "whether or not the expense is in connection with the taxpayers' trade or business, *if it is expended in the pursuit of income or in connection with property held for the production of income*, it is allowable." [Italics

supplied.] The report states explicitly (*infra*, p. 38) that expenses of administering a decedent's estate, including those incurred "in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section", and these expenses are distinguished from those incurred by an executor or administrator for the production or collection of income, which are deductible. The same distinction is elaborated in the applicable Treasury Regulations (Appendix, *infra*, pp. 30–35), in which it is provided explicitly that the non-deductible expenses of administration include those incurred "in conserving the assets for ultimate distribution to the parties entitled thereto." (*Infra*, p. 32.)

The principle thus stated to be embodied in the statute forms a consistent whole. On the one hand the management or conduct and maintenance of income-producing property, enterprises, and activity give rise to expenditures which are deductible in determining net income, except as specific considerations create exceptions;[4] on the other hand, the expenses incident to consumption or other personal activity and to the transfer and devolution of the beneficial ownership of property are not deductible unless specific provision for their allowance is made by statute. Where the same individuals incur both types of expenses in

[4] Cf. *McDonald* v. *Commissioner*, 323 U. S. 57.

relation to the same property during a single taxable year, disentanglement may at times be difficult; but we submit that the court below adopted the correct bases for making the distinction in this case. The fees and charges incurred in distributing the trust property to the University of North Carolina and to the ultimate beneficiaries bore no relation to the property as a source of income but had to do solely with its devolution. Their deduction from income for the taxable year would go counter both to the words and to the rationale of the statute.

Petitioners contend (Br. 25–27) that a distinction is to be drawn between executors and administrators on the one hand and trustees on the other, pointing out that the Treasury Regulation contains a separate provision for trustees (Appendix, *infra*, p. 33) which, however, merely repeats the language of the statute. They also point out that administration expenses which are not deductible from the income of a decedent's estate under Section 23 (a) (2) of the Internal Revenue Code are deductible from the gross estate for estate tax purposes; and they reason that, since no similar deduction can be made of trustees' expenses, a substituted allowance should be made with respect to income taxes. The fact, however, that transfers of property by trustees to beneficiaries are not subjected to a capital tax similar to the estate tax can scarcely become a ground

of conferring a benefit upon trust estates. There is no statutory basis for such a benefit. In an analogous situation which might be occasioned by a gift, it would scarcely be contended that the donor would be entitled to deduct from his income tax any expenses which were incident to making the gift, even if the gift were made from a body of property which the donor was holding for the production of income; nor would the gift tax be reduced by reason of such expenditures. Cf. *Coffey* v. *Commissioner,* 1 T. C. 579, 584, 589. Clearly the petitioners are far from sustaining the burden which rests upon them of demonstrating with definiteness that there is legal provision for the deduction which they seek. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Deputy* v. *du Pont,* 308 U. S. 488, 493; *Equitable Society* v. *Commissioner,* 321 U. S. 560, 564.

The Treasury Regulations have been consistent in characterizing expeditures of the type here in question as capital expenditures, chargeable against the corpus for tax purposes when there is a tax measured by the corpus, as in the case of the estate tax, but not deductible from income for income tax purposes. Treasury Regulations 103, Sec. 19.24–2, as amended, appendix, *infra,* p. 35. The distinction between capital expenditures and ordinary expenses has, of course, long been recognized. See, e. g., Art. 24–2, Treasury Regulations 101, 1938 Act; Art. 24–2, Treasury Regulations

94, 1936 Act; Art. 24–2, Treasury Regulations 86, 1934 Act; Art. 282, Treasury Regulations 77, 1932 Act; Art. 282, Treasury Regulations 74, 1928 Act; Art. 292, Treasury Regulations 69, 1926 Act. Cf. also *Jones' Estate* v. *Commissioner*, 127 F. 2d 231 (C. C. A. 5). The distinction applies fully to non-trade and non-business expenses under section 23 (a) (2) of the Internal Revenue Code. *Helvering* v. *Stormfeltz*, 142 F. 2d 982 (C. C. A. 8); *Bowers* v. *Lumpkin*, 140 F. 2d 927 (C. C. A. 4), certiorari denied, 322 U. S. 755; *Coughlin* v. *Commissioner*, 3 T. C. 420; but cf. *Heller* v. *Commissioner* (C. C. A. 9), decided January 27, 1945, 1945 C. C. H., vol. 4, par. 9169. Its application here leads to the conclusion that the fees and charges incurred in distributing the corpus of a trust estate are not deductible under that provision.

(b) *The Fees and Charges for Contesting the Income Tax Deficiency.*

With respect to the fees and charges of $16,439.96 which were incurred in contesting the income tax deficiency growing out of payment of the bequest of $5,000,000 to Louise Clisby Wise (*supra*, pp. 3, 6–7), different considerations come into play. These expenses were not paid in order to accomplish payment of the bequest but to protect the remainder of the trust property from liability for a tax upon the capital gain in the shares transferred. At the time the expenses were incurred the trust property was ready for distri-

bution.[5] By reason of the latter fact and because, in any event, the contested tax rested upon a past transaction and would not affect the yield or the value of invested capital, the Circuit Court of Appeals held that the cost of opposing the deficiency is not deductible.

The first and narrower ground of the decision below is sufficient in itself to determine this point of the case against the petitioners. We think the legal conclusion is correct that property which is awaiting distribution or being marshalled for distribution is held for that purpose and not for the production of any income that may accrue while it is so held. Therefore expenses which are incident to holding the property, rather than to the production of current income, are not deductible.

More broadly, however, the court below held, and the Government here contends, that even if the trust property be regarded as held for the production of income during the period the tax deficiency was contested, the expenses of the contest were not deductible. Plainly the holder of property for the production of income is not entitled to deduct the expenses of litigation unconnected with the property, merely because funds

[5] Under the terms of the testator's will the trust was to terminate 21 years from the date of the will—namely, September 23, 1937. (R. 19–20.) The fees and charges for contesting the tax deficiency were incurred during the period commencing August 27, 1937 and ending January 2, 1940. (R. 12–13.)

with which to satisfy a judgment against him might have to come from the property. In one sense, of course, opposition to such a judgment tends to conserve the property; but Section 23 (a) (2) of the Internal Revenue Code does not have reference to the expense of defending tort actions or of minimizing other unrelated obligations of one who holds property for the production of income, which may result adversely to the property. There must, rather, be a proximate relation between the litigation, with its expenses, and the property. The Congressional committee reports and the Treasury Regulations all state this requirement (see appendix, *infra*, pp. 31, 37, 41).

Applying this principle, the Regulation states with regard to taxes that

> Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income. [Appendix, *infra*, p. 34.]

The expenses here involved are far beyond the line thus drawn, which limits the deductibility of expenditures connected with taxes to those having to do with taxes upon the property which is held for the production of income. The principle stated by the court below, that the contested tax must affect the yield or the appreciation of the property, is more liberal, since it seemingly permits deducting the expense of contesting taxes upon income from the property being held, as well as upon the property itself. If the line were drawn more widely than this, the requisite proximate relation to the property would be lost; and we submit that the Circuit Court of Appeals correctly declined to regard the fees and charges for resisting the deficiency in this case as deductible.

Here the property which appreciated in value and thereby gave rise to the tax liability asserted by the Commissioner had left the trustees' hands before the deficiency was assessed. There was no relevant connection between it and the property which remained, except that they had once been part of a single estate. This, we submit, is insufficient. In no permissible sense could the petitioners be said to be managing, conserving, or maintaining the property which remained by opposing the assessment of taxes upon past gains from other property.

The decisions have on the whole been in accord with this view. Deduction of the expenses of

contesting taxes, which have not been shown to have a proximate relation to the management or preservation of property held for the production of income, or to income from the property, has not been allowed. *Higgins* v. *Commissioner,* 143 F. 2d 654 (C. C. A. 1); *Hord* v. *Commissioner,* 143 F. 2d 73 (C. C. A. 6); *Stoddard* v. *Commissioner,* 141 F. 2d 76 (C. C. A. 2); *Willmott* v. *Commissioner,* 2 T. C. 321; *McFaddin* v. *Commissioner,* 2 T. C. 395, 410–411. Cf., however, *Manning* v. *Commissioner,* 3 T. C. 853.

Estate of Bartholomew v. *Commissioner,* 4 T. C. No. 44, upon which petitioners rely (Br. 29), presents entirely different facts and was in any event, as we believe, wrongly decided upon the relevant issue, as to which two judges of the Tax Court dissented. *Kornhauser* v. *United States,* 276 U. S. 145, holds that expenses incurred in defense of an accounting suit in order to establish the right to business income collected in the past, are deductible as ordinary and necessary business expenses; but there the litigation related to the taxpayer's right to the income in the first instance. If, moreover, expenditures to retain business income are business expenses, as the Court stated (p. 153), it does not follow that expenditures to retain the income from property which has been transferred may be regarded as ordinary and necessary expenses of managing "property held for the production or collection" of that income.

CONCLUSION

We respectfully submit that the judgment of the Circuit Court of Appeals, which was in accord with the statute and the regulations, should be affirmed.

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APRIL 1945.

APPENDIX

Revenue Act of 1942, c. 619, 56 Stat. 798, amending Internal Revenue Code, Section 23:

SEC. 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

(a) *Deduction for Expenses.*—Section 23 (a) (relating to deduction for expenses) is amended to read as follows:

"(a) *Expenses.*—

* * * * * * *

"(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

* * * * * * *

(d) *Taxable Years to which Amendments Applicable.*—The amendments made by this section shall be applicable to taxable years beginning after December 31, 1938.

* * * * * * *

(26 U. S. C., Supp. III, Sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-15 (as inserted by T. D. 5196, 1942-2 Cum. Bull. 96, 97-100, and amended by T. D. 5280, 1943 Cum. Bull. 1022, and T. D. 5331, 1944-4 Int. Rev. Bull. 4). *Nontrade or Nonbusiness Expenses.*—(a) *In general.*—Subject to the qualifications and limitations in Chapter 1 and par-

ticularly in section 24, as amended, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * * Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. * * *

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or

maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. * * *

Capital expenditures, * * * are not allowable as nontrade or nonbusiness expenses. * * *

* * * * * *

Expenditures incurred by an administrator or executor in securing the processes and orders of the court having jurisdiction over the probate of the estate, or in collecting the assets of the estate (other than income which, if and when realized, must be reported by the estate for income tax purposes), or in adjusting claims against the decedent, or in distributing the remaining assets to the beneficiaries, or in conserving the assets for ultimate distribution to the parties entitled thereto, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or executor for the production or collection of income which, if and when realized, must be reported by the estate for income-tax purposes, such as fees for collecting rents on property in the estate of the decedent, or for collecting interest or dividends on securities in that estate, or which are paid or incurred during the taxable year for the management, conservation, or maintenance of property in the estate of the decedent held for the produc-

tion of income, the income from which, if and when realized, must be reported by the estate for income tax purposes, such as expenditures for insurance or repairs, or expenditures of a similar nature, are deductible under this section at the option of the taxpayer notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax, provided the requisite statement and waiver are filed. (See section 162 (e).)

* * * * *

Reasonable amounts paid or incurred by a trustee on account of trustees' fees and other expenses which are ordinary and necessary in connection with the production or collection of trust income or with the management, conservation, or maintenance of trust property held for the production of income are deductible, notwithstanding that the trust is not engaged in a trade or business.

* * * * *

It is immaterial whether the expenses of fiduciaries are paid from the corpus of the estate or from income. Expenses derive their character not from the fund from which they are paid, but from the purposes for which they are incurred.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is

also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7), added by section 130 (a) of the Revenue Act of 1942.) Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow ex-

penses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code can not again be deducted under any other provision thereof.

SEC. 19.24–2 (as amended by T. D. 5166, 1942–2 Cum. Bull. 87). *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (l).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. * * *

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74–76 (1942–2 Cum. Bull. 372):

6. NONTRADE OF NONBUSINESS DEDUCTIONS

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayers' trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable.

* * * * * *

SECTION 118. NONTRADE OR NONBUSINESS DEDUCTIONS

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred

either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the

management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Expenses incurred by an administrator or executor in the administration of the estate of a decedent, such, for example, as expenses in securing the processes and orders of the court having jurisdiction over the probate of an estate, or in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or an executor for the production or collection of income which must be reported by the estate for income tax purposes, may be claimed as deductions under this section notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax. Accordingly, subsection (c) of this section amends section 162 to provide that no deduction shall be allowed under

section 23 (a) (2) in computing the net income of the estate for amounts for which there may have been or has already been allowed a deduction under section 812 (b) in computing the net estate of the decedent. The present amendment would not allow as a deduction under section 23 (a) (2) for income tax purposes any amount which is allowable under section 812 (b) as a deduction in computing the net estate of a decedent for estate tax purposes, unless the Commissioner receives a statement, filed within the time and in the manner and form prescribed by him, to the effect that the amount in question has not been claimed or allowed as a deduction under section 812 (b) and that the right to have such items allowed at any time as a deduction under section 812 (b) is waived.

Subsection (d) of this section amends section 23 (l) of the Internal Revenue Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Internal Revenue Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87–88 (1942—2 Cum. Bull. 504):

SECTION 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS

This section is the same as section 118 of the House bill, except that subsection (c) of that section has been omitted therefrom and now appears as section 163 and a clerical amendment has been made in subsection (b). The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the

management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense

paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or more classes of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Subsection (c) of this section amends section 23 (l) of the Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear, and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior revenue act on the date of its enactment.

U. S. GOVERNMENT PRINTING OFFICE: 1945

SUPREME COURT OF THE UNITED STATES.

No. 932.—October Term, 1944.

Trust u/w of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Petitioners,
vs.
Commissioner of Internal Revenue.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[June 4, 1945.]

Mr. Chief Justice Stone delivered the opinion of the Court.

Petitioners are the trustees of a testamentary trust created for a term of twenty-one years under the will of Mary Lily (Flagler) Bingham. The testatrix bequeathed to the trustees the residue of her estate, including a large number of securities. The trustees were empowered in their discretion to sell any of the property held in trust (except certain securities of two companies designated as the "principal properties"), to invest and reinvest the proceeds and the income from the trust fund, and to use the proceeds and the income for the benefit of the principal properties and for the "maintenance, administration or development of the said principal or subsidiary properties." The trustees were to pay specified amounts annually to certain legatees. When the niece of the testatrix reached a certain age, she was to receive from the trust a specified amount in cash or securities. At the end of twenty-one years, the trustees were directed to pay other legacies, and to distribute the remainder of the fund in equal parts to a brother and two sisters of the testatrix.

In 1935 petitioners paid the bequest to the niece partly in securities. The Commissioner assessed a deficiency of over $365,000 for income tax upon the appreciation in value of the securities while they were in petitioners' hands. In contesting unsuccessfully this deficiency, petitioners paid out in the year 1940 approximately $16,000 in counsel fees and expenses. In that year, also, petitioners paid out about $9,000 for legal advice in connection with the payment of one of the cash legacies, and in connection with tax and other problems arising upon the expiration of the trust and relating to the final distribution of the trust fund among the three residuary legatees.

The question is whether these legal expenses, paid in 1940, are deductible from gross income in the computation of the trust's income tax, as "non-trade" or "non-business" expenses within the meaning of § 23(a)(2) of the Internal Revenue Code. That section, added by § 121 of the Revenue Act of 1942, and made applicable to tax years "beginning after December 31, 1938," authorizes the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." Section 162 of the Code, so far as now relevant, makes § 23(a)(2) applicable to the income taxation of trusts.

Petitioners, in their income tax return for 1940, took deductions for the legal expenses. The Commissioner disallowed the deductions and assessed a tax deficiency, and petitioners filed the present suit in the Tax Court to set aside the assessment. That Court, after finding the facts as we have stated them, found that the trust property was held for the production of income; that all the items in question were ordinary and necessary expenses of the management of the trust property; and that the fees and expenses for contesting the income tax deficiency assessment were also for the conservation of the trust property. It therefore concluded that all were rightly deducted in calculating the taxable net income of the trust. 2 T. C. 853.

On the Government's petition for review, the Court of Appeals for the Second Circuit reversed. 145 F. 2d 568. We granted certiorari, — U. S. —, on a petition which asserted as grounds for the writ that the decision of the Court of Appeals departed from the principles laid down in *Dobson* v. *Commissioner*, 320 U. S. 489, governing review of decisions of the Tax Court, and that the decision conflicted in principle with *Commissioner* v. *Heininger*, 320 U. S. 467, and *Kornhauser* v. *United States*, 276 U. S. 145.

The Court of Appeals left undisturbed the Tax Court's findings that the questioned items were ordinary and necessary expenses for the management or conservation of the trust property, but it held that the fees for contesting the tax deficiency were nevertheless not deductible under § 23(a)(2). It thought that the expenses of contesting the income tax had nothing to do with the production of income and hence were not deductible as expenses "for the production of income" within the meaning of the statute. The court also thought that these expenses were not deductible

ecause they were paid in connection with property held by the rustees "ready for distribution", and hence not "for the produc-ion of income." Similarly it held that the fees for professional ervices rendered in connection with the payment of legacies and he distribution of the trust fund, were not expenses relating to *he management of property held* for the production of income, ince they were rendered after the trust term had expired and vhen the property was ready for distribution.

The Government makes like arguments here. In addition it irges that the expenses in connection with the distribution of the rust fund were not expenses of management of the trust prop-rty held for the production of income but only expenses relating o its devolution; and that the expenses are not deductible under § 23(a)(2) because there was no proximate relationship between he expenses when paid and the property then held in trust.

We think that these objections to the deductions fail to take proper account of the plain language of § 23(a)(2), and the pur-ose of the section as disclosed by its statutory setting and legis-ative history; and that notwithstanding the weight of the Tax Court's decision against them, they raise questions of law review-able by the Circuit Court of Appeals and by this Court.

The requirement of § 23(a)(2) that deductible expenses be "or-linary and necessary" implies that they must be reasonable in amount and must bear a reasonable and proximate relation to the management of property held for the production of income. See H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75; Sen. Rep. No. 1631, 77th Cong., 2d Sess., p. 88. Ordinarily questions of reason-ableness and proximity are for the trier of fact, here the Tax Court. *Commissioner* v. *Heininger, supra,* 475; *McDonald* v. *Commis-sioner,* 323 U. S. 57, 64-65; see *Commissioner* v. *Scottish American Inv. Co.,* 323 U. S. 119. And even when they are hybrid ques-tions of "mixed law and fact", their resolution, because of the fact element involved, will usually afford little concrete guidance for future cases, and reviewing courts will set aside the decisions of the Tax Court only when they announce a rule of general applica-bility, that the facts found fall short of meeting statutory require-ments. *Dobson* v. *Commissioner, supra,* 502; *Commissioner* v. *Es-tate of Bedford,* No. 710, decided May 21, 1945; cf. Paul, "Dobson v. Commissioner," 57 Harv. Law Rev. 753, at 828-832, 836-837. But whether the applicable statutes and regulations are such as to preclude the decision which the Tax Court has rendered, is, as was recognized in *Dobson* v. *Commissioner, supra,* 492-493, a ques-

tion of law reviewable on appeal. See also *Commissioner* v. *Heininger, supra,* 475.

Here the decision of the Court of Appeals was that the expenses were not deductible because they were not for the purpose of producing income or capital gain, and because the trust property, being ready for distribution, was no longer held for the production of income. The terms of the trust, the nature of the property, and the duties of the trustees with respect to it, were all found by the Tax Court and are not challenged. The questions whether, on the facts found, the expenses in question are non-deductible, either because they were not to produce income or because they were related to the management of property which was not held for the production of income, turn in this case on the meaning of the words of § 23(a)(2), "property held for the production of income". They are therefore questions of law, decision of which is unembarrassed by any disputed question of fact or any necessity to draw an inference of fact from the basic findings. See *Commissioner* v. *Scottish American Inv. Co., supra.* They are "clear cut" questions of law, decision of which by the Tax Court does not foreclose their decision by appellate courts, as in other cases, *Dobson* v. *Commissioner, supra,* 492-493, although their decision by the Tax Court is entitled to great weight. *Dobson* v. *Commissioner, supra,* 501-502, and cases cited; cf. *Medo Photo Supply Corp.* v. *Labor Board,* 321 U. S. 678, 681-682, n. 1, and cases cited.

Since our decision in the *Dobson* case we have frequently re-examined, as matters of law, determinations by the Tax Court of the meaning of the words of a statute as applied to facts found by that court.[1] A question of law is not any the less such because the Tax Court's decision of it is right rather than wrong. Whether or not its decision is "in accordance with law" is a question which the statute, Int. Rev. Code, § 1141(c)(1), expressly makes subject to appellate review. Congress, when it thus author-

[1] See, e. g., Security Mills Co. v. Commissioner, 321 U. S. 281, 286; Douglas v. Commissioner, 322 U. S. 275; Commissioner v. Harmon, 323 U. S. 44; McDonald v. Commissioner, 323 U. S. 57; Claridge Apartments Co. v. Commissioner, 323 U. S. 141, 145; Fondren v. Commissioner, No. 88, decided January 29, 1945; Choate v. Commissioner, No. 93, decided January 29, 1945; Commissioner v. Field, No. 578, decided February 5, 1945; Webre Steib Co. v. Commissioner, No. 148, decided February 12, 1945; Commissioner v. Smith, No. 371, decided February 26, 1945; Commissioner v. Wemyss, No. 629, decided March 5, 1945; Commissioner v. Wheeler, No. 354, decided March 26, 1945; Estate of Putnam v. Commissioner, No. 534, decided March 26, 1945; Angelus Milling Co. v. Commissioner, No. 610, decided May 21, 1945; Commissioner v. Bedford, No. 710, decided May 21, 1945; Commissioner v. Disston, No. 589, decided this day.

ized review of questions of law only, was not unaware of the difficulties of such a review of the decisions of a tribunal, which decides questions both of law and of fact. But Congress did not dispense with such review.

Hence the statute does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. That can only be ascertained upon resort to the prescribed appellate process by a consideration of the merits of the point of law involved, and by its decision at the conclusion of the process, not before it begins. The fact that the Court of Appeals below, while accepting the Tax Court's findings of fact, has nevertheless reversed its decision, would seem not to leave the question of law decided so free from doubt that the mandate of the statute could rightly be disregarded on any theory. If review were to be denied in this case, it would be difficult to say that any construction of a taxing statute by the Tax Court would be subject to appellate review.

We turn to the first ground for reversal relied on by the Court of Appeals, that the property was held for distribution, and no longer for the production of income. The fact that the trustees, in the administration of the trust, were required to invest its corpus for the production of income and to devote the income to the purposes of the trust, establishes, as the Tax Court held, that the trust property was held for the production of income during the stated term of the trust. The decisive question is whether the property ceased to be held for the production of income because, as the trust term reached its expiry date, the trustees were under a duty to distribute the property among the remaindermen.

It is true that expiration of the trust operated to change the beneficiaries entitled to receive the income of the trust property, from those entitled to the income during the term of the trust to the remaindermen. But the duty of the trustees to hold and conserve the trust property, and until distribution, to receive income from it, continued. The property did not cease to be held for the production of income because, upon the expiration of the trust and until distribution, the trustees were under an additional duty to distribute the trust fund, or because the trustees, upon distribution, were then accountable to new and different beneficiaries, the residuary legatees, both for the principal of the fund and any income accumulating after the expiry date. To exclude from the deduction privilege, expenses which the Tax Court has held to be expenses of management of the trust, on the ground that the trust fund, upon the expiration of the trust,

ceased to be "held for the production of the income" would be to disregard the Tax Court's findings of fact and the words of the statute, and would defeat its obvious purpose.

Nor is there merit in the court's conclusion that the expenses were not deductible because they were not for the production of income. Section 23(a)(2) provides for two classes of deductions, expenses "for the production . . . of income" and expenses of "management, conservation or maintenance of property held for the production of income." To read this section as requiring that expenses be paid for the production of income in order to be deductible, is to make unnecessary and to read out of the section the provision for the deduction of expenses of management of property held for the production of income.

There is no warrant for such a construction. Section 23(a)(2) is comparable and *in pari materia* with § 23(a)(1), authorizing the deduction of business or trade expenses. Such expenses need not relate directly to the production of income for the business. It is enough that the expense, if "ordinary and necessary," is directly connected with or proximately results from the conduct of the business. *Kornhauser* v. *United States*, *supra*, 152-153; *Commissioner* v. *Heininger*, *supra*, 470-471. The effect of § 23(a)(2) was to provide for a class of non-business deductions coextensive with the business deductions allowed by § 23(a)(1), except for the fact that, since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or in the management or conservation of property held for the production of income. *McDonald* v. *Commissioner*, *supra*, 61-62, 66; and see H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74-76; S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88.

Since there is no requirement that business expenses be for the production of income, there is no reason for that requirement in the case of like expenses of managing a trust, so long as they are in connection with the management of property which is held for the production of income. Section 23(a)(2) thus treats the trust as an entity for producing income comparable to a business enterprise, and like § 23(a)(1) permits deductions of management expenses of the trust, even though the particular expense was not an expense directly producing income. It follows that all of the items of expense here in question are deductible if, as the Tax Court has held, they are expenses of management or conservation of the trust fund, whether their expenditure did or did not result in the production of income.

The Government contends that the expenses incurred in connection with the distribution of the corpus of the trust to legatees, are not deductible, because they are not expenses of managing income producing property, but expenses in connection with the devolution of the property. If the suggestion is correct, it would follow that expenses incurred in distributing the income of the trust to the income beneficiaries are likewise not deductible, since the distribution of income is also a devolution of trust property. But the duties of the trustees were not only to hold the property for the production of income and to collect the income, but also, in administering the trust, to distribute the income and the principal so held from time to time, and the remainder of the principal at the expiration of the trust. Performance of each of these duties is an integral part of carrying out the trust enterprise. Accordingly, as the Tax Court held, the costs of distribution here were quite as much expenses of a function of "management" of the trust property as were expenses incurred in producing the trust income; and if "ordinary and necessary," they were deductible.

In support of its contention, the Government relies upon a part of the House Committee Report, accompanying the bill which became the Revenue Act of 1942, see H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75, and upon Treas. Regs. 103, § 19.23(a)-15, neither of which was mentioned by the Court of Appeals. They state that an administrator or executor may not deduct expenses incurred in the administration of the estate of a decedent, including those of distributing assets to the beneficiaries. It is argued that by analogy like expenses of trustees should not be deductible. But it is to be noted that there is no such statement in the Report or Regulations as to the distribution expenses of trustees. On the contrary, the Regulations, § 19.23(a)-15, in dealing specifically with expenses of trustees, provides only that their expenses of management and conservation of the trust property held for the production of income are deductible. And the references in the Report to the non-deductibility of expenses of administrators and executors were in explanation of the Congressional purpose to prevent the specified administration expenses from being deductible both for income and estate taxation. To accomplish that purpose the Report recommended an amendment, which became § 161(a) of the Revenue Act of 1942, adding § 162(e) to the Internal Revenue Code. Section 162(e) provides, with an immaterial exception, that "amounts allowable under § 812(b) as a deduction in computing the net estate of a decedent shall not be

allowed as a deduction under § 23." Here, as the Tax Court found, there is no possibility of such a double deduction, since the expenses were not deductible under the decedent's estate tax return.

What we have said applies with equal force to the expenses of contesting the tax deficiency. Section 23(a)(2) does not restrict deductions to those litigation expenses which alone produce income. On the contrary, by its terms and in analogy with the rule under § 23(a)(1), the business expense section, the trust, a taxable entity like a business, may deduct litigation expenses when they are directly connected with or proximately result from the enterprise—the management of property held for production of income. *Kornhauser* v. *United States, supra,* 152-153; *Commissioner* v. *Heininger, supra,* 470-471. The Tax Court could find as a matter of fact, as it did, that the expenses of contesting the income taxes were a proximate result of the holding of the property for income. And we cannot say, as a matter of law, that such expenses are any less deductible than expenses of suits to recover income. Cf. *Commissioner* v. *Heininger, supra.*

The Government relies on Treas. Regs. 103, § 19.23(a)-15, which provide that "expenditures incurred . . . for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income) are not deductible expenses under this section [§ 23(a)(2) of the Code], except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income." So far as this regulation purports to deny deduction of litigation expense unless it is to produce income, it is not in conformity to the statute, for the reasons already stated, or with the Regulation already mentioned, which provides that in addition to expenses for the production or collection of trust income, expenses of management or conservation of trust property held for the production of income are also deductible. To that extent and to the extent that it departs from the rule of *Kornhauser* v. *United States, supra,* it conflicts with the meaning and purpose of § 23(a)(2), and so is unauthorized. *Helvering* v. *Reynolds Tobacco Co.,* 306 U. S. 110.

We find no error of law in the judgment of the Tax Court. Its judgment will be affirmed and that of the Court of Appeals reversed.

Reversed.

SUPREME COURT OF THE UNITED STATES.

No. 932.—October Term, 1944.

Trust u/w of Mary Lily (Flagler) Bingham, William R. Kenan, Jr., and Lawrence C. Haines, Trustees, Petitioner, *vs.* Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[June 4, 1945.]

Mr. Justice Frankfurter, concurring.

This is one of those cases in which the ground of the decision is more important than the decision itself, except to the parties. And so, while I concur in the result, I feel bound to say that I think the manner in which it is reached is calculated to increase the already ample difficulties in judicial review of Tax Court determinations. The course of our decisions since *Dobson* v. *Commissioner*, 320 U. S. 489, calls for clarification and avoidance of further confusion.

In *Dobson* v. *Commissioner, supra*, this Court elaborately considered the special function of the Tax Court and the very limited functions of the Circuit Courts of Appeals and of this Court in reviewing the Tax Court. The unanimous opinion in the *Dobson* case was surely a case of much ado about nothing, if it did not emphasize the vast range of questions as to which the Tax Court should have the final say. In making the *Dobson* pronouncement, the Court was not unaware that "questions of fact" and "questions of law" were legal concepts around which dialectic conflicts have been fought time out of mind. The *Dobson* opinion took for granted that they are useful instruments of thought even though not amenable to fixed connotations. The terms are unmanageable and too confusing if it be assumed that unless they have invariant meaning, that is, unless they serve the same purpose for every legal problem in which they are invoked, they can serve no purpose for any problem. The contribution of the *Dobson* case, one had a right to believe, was the restriction of reviewable "questions of law" in tax litigation to issues appropriate for review in

relation to the machinery which Congress has designed for such litigation. The *Dobson* case eschewed sterile attempts at differentiation between "fact" and "law" in the abstract. Instead, it found significance in the scheme devised by Congress for adjudicating tax controversies whereby Congress had, in the main, centralized in the Tax Court review of tax determinations by the Treasury and had made the decisions of the Tax Court final unless they were "not in accordance with law", 44 Stat. 9, 110, 26 U. S. C. § 1141(c)(1), with the result that, as a practical matter, only a small percentage of Tax Court decisions gets into the Circuit Courts of Appeals, and a still smaller percentage reaches this Court.[1] Therefore, the decisions of the Circuit Courts of Appeals, and even more so of this Court, are bound to be more or less episodic and dependent upon contingencies that cannot give these appellate courts that feel of the expert which is so important for wise construction of such interrelated and complicated enactments as those which constitute our revenue laws. These factors, so decisive in the stream of tax litigation, weigh heavily in apportioning functions between the Tax Court and the courts reviewing the Tax Court. Accordingly, the vital guidance of the *Dobson* opinion was that a decision of the Tax Court should stand unless it involves "a clear-cut mistake of law", 320 U. S. 489, 502. Considerations that may properly govern what are to be deemed questions of fact and questions of law as between judge and jury, or considerations relevant to the drawing of a line between questions of fact and questions of law on appeal from a court of first instance sitting without a jury, or in determining what is a foreclosed question of fact in cases coming to this Court from State courts on claims of unconstitutionality, may be quite misleading when a decision of the Tax Court is challenged in the various Circuit Courts of Appeals or here as "not in accordance with law".

Certainly, all disputed questions regarding events and circumstances—the raw materials, as it were, of situations which give rise to tax controversies—are for the Tax Court to settle and defi-

[1] As a matter of historic survival, some tax litigation still reaches district courts throughout the country. To that extent there is a qualification upon the centralization of review in the Tax Court of Treasury determinations. But the overwhelming volume of tax litigation goes to the Tax Court. The ratio is about 6 to 1. The fact that the district courts continue to have vestigial jurisdiction may call for a scientific revamping of jurisdiction in tax cases. It does not counsel against giving the fullest efficacy to Tax Court decisions consonant with its special responsibility. See Griswold, The need for a Court of Tax Appeals (1944) 57 Harv. L. Rev. 1153; Miller, Can Tax Appeals be Centralized? (1945) 23 Taxes 303.

nitively so. Secondly, there are questions that do not involve disputes as to what really happened—as, for instance, what expenses were incurred or what distribution of assets was made—but instead turn on the meaning of what happened as a matter of business practice or business relevance. Here we are in the domain of financial and business interpretation in relation to taxation as to which the Tax Court presumably is as well informed by experience as are the appellate judges and certainly more frequently enlightened by the volume and range of its litigation. Such issues bring us treacherously near to what abstractly are usually characterized as questions of law, whether the question of division of labor in a litigation is between judges and lay juries, or between judges of first instance and of appellate courts when there is no difference of specialized experience between the two classes of judges. Thus, the construction of documents has for historic reasons been deemed to be a question of law in the sense that the meaning is to be given by judges and not by laymen. But this crude division between what is "law" and what is "fact" is not relevant to the proper demarcation of functions as between the Tax Court and the reviewing courts. To hold that the Circuit Courts of Appeals, and eventually this Court, must make an independent examination of the meaning of every word of tax legislation, no matter whether the words express accounting, business or other conceptions peculiarly within the special competence of the Tax Court, is to sacrifice the effectiveness of the judicial scheme, designed by Congress especially for tax litigation to an abstract notion of "law" derived from the merely historic function of courts generally to construe documents, including legislation. More than that. If the appellate courts must make an independent examination of the meaning of every word in tax legislation, on the assumption that the construction of legislative language is necessarily for the appellate courts, how can they reasonably refuse to consider claims that the words have been misapplied in the circumstances of a particular case? Meaning derives vitality from application. Meaning is easily thwarted or distorted by misapplication. If the appellate courts are charged with the duty of giving meaning to words because they are contained in tax legislation, they equally cannot escape the duty of examining independently whether a proper application has been given by the Tax Court.

The specialized equipment of the Tax Court and the trained instinct that comes from its experience ought to leave with the Tax Court the final say also as to matters which involve construction of legal documents and the application of legislation even though the process may be expressed in general propositions, so long as the Tax Court has not committed what was characterized in the *Dobson* case as a "clear-cut mistake of law".

That serves as a guide for judgment even though no inclusive definition or catalogue is essayed. The Tax Court of course must conform to the procedural requirements which the Constitution and the laws of Congress command. Likewise, in applying the provisions of the revenue laws, the Tax Court must keep within what may broadly be called the outward limits of categories and classifications expressing legislative policy. Congress has invested the Tax Court with primary—and largely with ultimate—authority for redetermining deficiencies. It is a tribunal to which mastery in tax matters must be attributed. The authority which Congress has thus given the Tax Court involves the determination of what really happened in a situation and what it means in the taxing world. In order to redetermine deficiencies the Tax Court must apply technical legal principles. The interpretation of tax statutes and their application to particular circumstances are all matters peculiarly within the competence of the Tax Court. On the other hand, constitutional adjudication, determination of local law questions and common law rules of property, such as the meaning of a "general power of appointment" or the application of the rule against perpetuities, are outside the special province of the Tax Court. See Paul, *Dobson* v. *Commissioner: the Strange Ways of Law and Fact* (1944) 57 Harv. L. Rev. 753, 847-48. Congress did not authorize review of all legal questions upon which the Tax Court passed. It merely allowed modification or reversal if the decision of the Tax Court is "not in accordance with law". But if a statute upon which the Tax Court unmistakably has to pass allows the Tax Court's application of the law to the situation before it as a reasonable one—if the situation could, without violence to language, be brought within the terms under which the Tax Court placed it or be kept out of the terms from which that Court kept it—the Tax Court cannot in reason be said to have acted "not in accordance with law". In short, there was no "clear-cut mistake of law" but a fair administration of it.

If these considerations are to prevail, the sole question before a Circuit Court of Appeals is whether the decision by the Tax Court presents a "clear-cut mistake of law". There should be an end of the matter once it is admitted that the application made by the Tax Court was an allowable one. If a question becomes a reviewable question in tax cases because, abstractly considered, it may be cast into a "pure question of law", it would require no great dialectical skill to throw most questions which are appealed from the Tax Court into questions of law independently reviewable by the Circuit Courts of Appeals. The road would be open to a new insistence for increased tax reviews by this Court on *certiorari*. The intention of the *Dobson* case was precisely otherwise. It was to centralize responsibility in the Tax Court, to minimize isolated intrusions by the Circuit Courts of Appeals into the technical complexities of tax determinations except when the Tax Court has clearly transcended its specialized competence, and to discourage resort to this Court in tax cases except where conflict among the circuits or constitutional questions or a "clear-cut mistake of law" of real importance may call for our intervention.

Let us apply these governing considerations to the case in hand. The trustees here paid, as expenses in connection with the trust, certain legal fees, and these charges they deducted from the gross trust income for 1940. The Commissioner disallowed these deductions. The legal services concerned (1) litigation in which the trustees unsuccessfully contested a deficiency claim based on taxable gain to the estate, (2) payment of a legacy, and (3) problems arising from the expiration of the trust and the disposition of its assets. The sole question before the Tax Court was whether these fees and charges were deductible as expenses incurred "for the management, conservation, or maintenance of property held for the production of income" under § 121(a) of the Revenue Act of 1942, 56 Stat. 798, 819.

Whether these payments constituted expenses "for the management . . . of property held for the production of income," may as fairly be said to be a question of fact, namely, the purpose which these payments served with relation to property held for the production of income, as it could be said that they involve a proper construction of what the statute means by "management" of such property. The truth of the matter is that the problem involves a judgment regarding the interplay of both questions, namely, what

relation do these payments have to what may properly be deemed the managerial duties of trustees. It is possible to transform every so-called question of fact concerning the propriety of expenses incurred by trustees into a generalized inquiry as to what the duties of a trustee are and, therefore, whether a particular activity satisfied the conception of management which trusteeship devolves upon a trustee. Such a way of dealing with these problems inevitably leads to casuistries which are to be avoided by a fair distribution of functions between the Tax Court and the reviewing courts. The fact that this problem may be cast in the form of intellectually disinterested abstractions goes a long way to prove that its solution should be left with the Tax Court.

If the decision by the Tax Court may fairly be deemed to have been restricted to the facts of this case, as it may, it certainly would be an issue of "fact". But even assuming that the "issues are broader than the particular facts presented" by this case, the Tax Court's decision is not deprived of finality. Yet an assumption to the contrary is at the core of the Government's argument. Simply because the correctness of "certain general propositions" is involved does not make the position taken by the Tax Court a question of law. The real question is: What is the nature of the issue upon which the Tax Court has pronounced? If the issue presents a difficulty which it is peculiarly within the competence of the Tax Court to resolve and that court has given a fair answer, every consideration which led to the pronouncement in the *Dobson* case should preclude independent reexamination of the Tax Court's disposition. Regardless of what the question may be termed for purposes of review, the Tax Court's determination should be accorded finality. That the Tax Court has expressed an allowable opinion as to the meaning and application of a tax provision, here §121 (a) of the 1942 Revenue Act, should suffice to reinstate its decision, without opening the sluices to independent review by the Circuit Courts of Appeals and this Court of multitudinous tax questions. Such is the principle or rule of judicial administration which should guide review of Tax Court determinations.

Mr. Justice ROBERTS and Mr. Justice JACKSON join in this concurring opinion.